United States Court of Appeals

for the Second Circuit



BRIEF FOR APPELLANT

ORIGINAL
WITH PROOF
OF SERVICE

76-7259

To be argued by
REGINALD LEO DUFF

B
P/S

United States Court of Appeals

FOR THE SECOND CIRCUIT

THOMAS J. BYRNES and FRANCIS R. SANTANGELO,
Plaintiffs-Appellants,

—against—

FAULKNER, DAWKINS & SULLIVAN and SINGER & MACKIE, INC.,
Defendants-Appellees.

FAULKNER, DAWKINS & SULLIVAN,
Counterclaim-Plaintiff, Appellee, Appellant,

—against—

THOMAS J. BYRNES and FRANCIS R. SANTANGELO,
Counterclaim-Defendants, Appellants, Appellees,

and

TOBEY & KIRK,
Counterclaim-Defendant-Appellee.

UNITED STATES COURT OF APPEALS
FILED
AUG 16 1976
SECOND CIRCUIT

BRIEF OF THE PLAINTIFFS-APPELLANTS AND COUNTERCLAIM-DEFENDANTS-APPELLANTS

CARRO, SPANBOCK, LONDIN, RODMAN & FASS
Attorneys for Plaintiffs-Appellants and Counterclaim Defendants-Appellants, Appellees, Thomas J. Byrnes and Francis R. Santangelo
10 East 40th Street*
New York, New York 10016
Tel. (212) 889-3600

REGINALD LEO DUFF,
Of Counsel.

* After September 2, 1976:
1345 Avenue of the Americas
New York, New York 10019
Tel. (212) PL 7-2400

TABLE OF CONTENTS

Index	i
Table of Authorities	iii
Preliminary Statement	1
Statement of Facts	3
Sword vs. Shield	6
Questions Presented	7
POINT I: IN GRANTING SUMMARY JUDGMENT TO FAULKNER ON THE SECOND AFFIRMATIVE DEFENSE, AND IN DENYING SUMMARY JUDGMENT TO PLAINTIFFS THEREON, THE COURT BELOW GAVE INSUFFICIENT WEIGHT TO THE LEGISLATIVE HISTORY, PURPOSE AND POLICY OF THE SECURITIES ACT	10
The Statutory Framework	11
(a) The History of § 2(10)---both before and after the amendment of 1954---does not support the application of § 2(10) to brokers' "comparisons"	13
Application of General Counsel's Opinion	25
(b) The Court below applied improper standards of construction	28
POINT II: THE COURT BELOW ERRONEOUSLY DENIED SUMMARY JUDGMENT TO PLAINTIFFS ON THE THIRD AFFIRMATIVE DEFENSE, ALTHOUGH THE DEFENSE IS INSUFFICIENT AS A MATTER OF LAW AND FACT	39
(a) Tobey & Kirk was not an "underwriter" as a matter of law, so that the failure of the prospectus to identify it as such was not a violation of the Act	40
(b) Even if Tobey & Kirk were a statutory "underwriter" the failure to disclose that conclusion was not a material omission	42

(c) The Court below erred in denying summary judgment to plaintiffs on the Third Affirmative Defense because of the existence of putative issues of fact concerning plaintiffs' own status as "underwriters" and the knowledge of Faulkner 44

POINT III: THE COURT BELOW IMPROPERLY DEPRIVED PLAINTIFFS OF THE RIGHT TO INVOKE THE EXCULPATORY PROVISIONS OF SECTION 19(a) OF THE SECURITIES ACT BECAUSE THEY WERE SUING RATHER THAN BEING SUED AND BECAUSE OF PUTATIVE ISSUES OF FACT 46

(a) The Court's refusal to permit plaintiffs to invoke § 19(a) because they are suing rather than being sued is inconsistent with the policy of the Act 47

(b) The failure to deliver a prospectus with the "comparison," and the failure to identify Tobey & Kirk as an "underwriter" "conformed" to SEC rules and regulations within the meaning of § 19(a) 54

(c) The Court improperly denied summary judgment as to the Third Defense on the basis of suppositions of facts not of record and contrary to the common registration practice 57

POINT IV: THE COURT BELOW ERRED IN REFUSING SUMMARY JUDGMENT TO PLAINTIFFS DISMISSING THE FIRST DEFENSE BECAUSE THE TESTIMONY OF FAULKNER'S TRADERS ESTABLISHES THAT THE RULE 10b-5 DEFENSE INVOLVES ONLY A QUESTION OF LAW, NOT ONE OF FACT 62

(a) Plaintiffs did not violate Rule 10b-5, as a matter of law, because Faulkner's self-imposed ignorance of publicly-available facts prevented it from understanding plaintiffs' truthful disclosures 64

(b) The undisputed facts are that plaintiffs did disclose that their stock was in registration and could not be sold without "SEC clearance" 71

MacMillen's Testimony 73

Lattuga's Testimony 78

Green's Testimony 80

POINT V: SUMMARY JUDGMENT SHOULD HAVE BEEN GRANTED TO PLAINTIFFS AS TO FAULKNER'S SEVENTH AFFIRMATIVE DEFENSE BECAUSE FAULKNER ADDUCED NO EVIDENCE THAT IT WAS PREJUDICED BY PLAINTIFFS' DELAY IN COMMENCING RESALES OF THE STOCK 82

POINT VI: THE COURT BELOW ERRED IN DISMISSING THE COMPLAINT FOR LACK OF SUBJECT MATTER JURISDICTION 95

CONCLUSION 99

Table of Authorities

Cases:

A. C. Frost & Co. v. Coeur D'Alene Mines Corp., 312 U.S. 38 (1943) 50*, 52, 53, 96

Arber v. Essex Wire Corp., 490 F.2d 414 (6th Cir. 1974) 69*

Bache & Co. v. International Controls Corp., 339 F.Supp. 341 (S.D.N.Y. 1972) 83, 84
aff'd, 469 F.2d 696 (2d Cir. 1972) 83

Bigelow v. RKO Radio Pictures, Inc. 327 U.S. 251 (1946) 94

Bird v. Ferry, 497 F.2d 112 (5th Cir. 1974) 94*

Byrnes v. Faulkner, Dawkins & Sullivan, 362 F.Supp. 864 (S.D.N.Y. 1973) 2, 6, 95*, 96, 97, 98, 99
CCH Sec.L.Rep. ¶ 95,463 (S.D.N.Y. 1966) passim
28*, 29*, 30*, 34*, 37*, 44-45*, 47-48*, 58*, 64*, 82*

Chasins v. Smith, Barney & Co., 438 F.2d 1167 (2d Cir. 1970) 37, 94

Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F.2d 341 (2d Cir. 1973) 43

---

*Indicated quoted matter.

Collins Securities Corp., Matter of,
Release No. 11,766,
CCH Sec.L.Rep. ¶ 80,327 (1975) passim, 130-46*
33*, 38*

Cort v. Ash, 422 U.S. 66 (1976) 96*

Diskin v. Lomasney & Co., 452 F.2d 871
(2d Cir. 1971) 19, 20*, 36

Eason v. General Motors Acceptance Corp.,
490 F.2d 654 (7th Cir. 1973) 65*

Eastman Kodak Co. v. Southern Photo Materials Co.,
273 U.S. 359 (1927) 94

Engl v. Aetna Life Ins. Co.,
139 F.2d 467 (2d Cir. 1943) 59

Escott v. BarChris Constr. Corp.,
283 F.Supp. 643 (S.D.N.Y. 1968) 43

Exchange National Bank v. Touche Ross & Co.,
___ F.2d ___, CCH Sec.L.Rep. ¶ 95,614
(2d Cir. 1976) 13

Feit v. Leasco Data Processing Equip. Co.,
332 F.Supp. 544 (E.D.N.Y. 1971) 43

Foremost-McKesson, Inc. v. Provident Securities Co.,
423 U.S. 232 (1976) 97
aff'g. 506 F.2d 601 (9th Cir. 1974) 97
aff'g. 331 F.Supp. 787 (N.D.Cal. 1971) 98

Frigitemp Corp. v. Financial Dynamics Fund,
524 F.2d 275 (2d Cir. 1975) 67*

Garfield v. Strain, 320 F.2d 116 (10th Cir. 1963) 52, 53*

Gerstle v. Gamble-Skogmo, Inc.,
478 F.2d 1281 (2d Cir. 1973) 41, 55-56

Globus v. Law Research Service, Inc.,
418 F.2d 1276 (2d Cir. 1969) 18, 43

Gruss v. Curtis Publ. Co., ___ F.2d ___,
CCH Sec.L.Rep. ¶ 95,524
(2d Cir. 1974) 45, 67, 73

Gully v. First National Bank, 299 U.S. 109 (1936) 95, 96

---

*Indicates quoted matter.

Hagen Investments Inc., Matter of,
SEC Release No. 9325,
'71-'72 CCH Sec.L.Rep. ¶ 78,302 (1971) 89

Jaffee & Co., Matter of,
CCH Sec.L.Rep. ¶ 77,805 (1970) passim

Jaffee & Co. v. SEC, 446 F.2d 387 (2d Cir. 1971) 4

James v. DuBrieul, 500 F.2d 155 (5th Cir. 1974) 51

J. I. Case Co. v. Borak, 377 U.S. 426 (1964) 96-97*, 98-99*

Kaiser-Frazer Corp. v. Otis & Co.,
195 F.2d 838 (2d Cir. 1952) 51, 52*

Kohler v. Kohler Co., 319 F.2d 634 (7th Cir. 1963) 68-69*

Kuehnert v. Texstar Corp., 412 F.2d 700
(5th Cir. 1969) 51

Mayer v. Monzo, 221 N.Y. 442 (1917) 84

Merritt, Vickers, Inc. v. SEC,
353 F.2d 293 (2d Cir. 1965) 92

Opper v. Hancock Securities Corp.,
250 F.Supp. 668 (S.D.N.Y. 1966) 92*
aff'd, 367 F.2d 157 (2d Cir. 1966) 92

Pinto v. Maremont Corp., 326 F.Supp. 165 (S.D.N.Y. 1971) 98

Radio City Music Hall Corp. v. United States,
135 F.2d 715 (2d Cir. 1943) 59

Sarlie v. E. L. Bruce Co.,
265 F.Supp. 371 (S.D.N.Y. 1967) 94

Schillner v. H. Vaughan Clarke & Co.,
134 F.2d 875 (2d Cir. 1943) 53

SEC v. Capital Gains Research Bureau, Inc.,
375 U.S. 180 (1963) 30, 34

SEC v. Coffey, 493 F.2d 1304 (6th Cir. 1974) 67-68*

SEC v. Harwyn Industries Corp.,
326 F.Supp. 943 (S.D.N.Y. 1971) 56*, 57

SEC v. Manor Nursing Centers, Inc.,
458 F.2d 1082 (2d Cir. 1972) 43

---

*Indicates quoted matter.

SEC v. Texas Gulf Sulphur Co.,
401 F.2d 833 (2d Cir. 1968) 73

Story Parchment Co. v. Paterson Parchment Co.,
282 U.S. 555 (1931) 94

Thomas v. Duralite Co., Inc.,
524 F.2d 577 (3d Cir. 1975) 67

Vohs v. Dickson, 495 F.2d 607 (5th Cir. 1974) 45*, 46, 65*, 69*

Zeller v. Bogue Elec. Mfg. Co.,
476 F.2d 795 (2d Cir. 1973) 94

Statutes:

Securities Act of 1933, 15 U.S.C. § 77a, ff.

Section 2, 15 U.S.C. § 77b 12

Section 2(4), 15 U.S.C. § 77b(4) 41, 101*

Section 2(10), 15 U.S.C. § 77b(10) passim, 101*
As enacted in 1933 14*

Section 2(11), 15 U.S.C. § 77b(11) 20, 42, 102*

Section 2(12), 15 U.S.C. § 77b(12) 18, 102*

Section 4, 15 U.S.C. § 77d passim, 102*

Section 4(1), 15 U.S.C. § 77d(1) 20, 23, 24, 25

Section 4(3), 15 U.S.C. § 77d(3) 20

Section 4(4), 15 U.S.C. § 77d(4) 20, 21, 24, 25, 26

Section 5, 15 U.S.C. § 77e passim, 103*

Section 5(b)(1), 15 U.S.C. § 77e(b)(1) passim

Section 5(b)(2), 15 U.S.C. § 77e(b)(2) 20

Section 7, 15 U.S.C. § 77g 11, 103-04*

Section 10, 15 U.S.C. § 77j 11, 103-04*

Section 11, 15 U.S.C. § 77k 51

Section 11(a), 15 U.S.C. § 77k(a) 42, 43, 106*

---

*Indicates quoted matter.

Section 12, 15 U.S.C. § 77l 12, 51, 96, 107*
Section 12(2), 15 U.S.C. § 77l(2) 31, 42, 43, 53
Section 13, 15 U.S.C. § 77m 12
Section 14, 15 U.S.C. § 77n 96
Section 19(a), 15 U.S.C. § 77s(a) passim, 46*, 107*
Section 22(a), 15 U.S.C. § 77v(a) 98
Section 27, 15 U.S.C. § 77aa 11
Securities Exchange Act of 1934, 15 U.S.C. § 78
Section 10(b), 15 U.S.C. § 78j(b) 108*
Section 16(b), 15 U.S.C. § 78p(b) 97
Section 23(a), 15 U.S.C. § 78w(a) 55
Section 27, 15 U.S.C. § 78aa 98
Section 29(b), 15 U.S.C. § 78cc(b) 97
Title 28, U.S. Code
28 U.S.C. § 1291 1
Uniform Commercial Code
§ 1-106 84, 111*
§ 2-706 82, 83, 84, 111*
§ 2-708(1) 82, 84, 111*
§ 2-708(2) 83, 111*
§ 8-107(2) 83, 112*
Rules and Regulations:
FRCP 56(e) 9, 59
FRCP 56(f) 59
Rule 154, 17 CFR § 230.154 23, 32

---

*Indicates quoted matter.

Securities Act Release No. 33-828, June 4, 1936
11 F.R. 10957, 17 CFR § 231.828
Vol. 1, CCH Sec.L.Rep. ¶ 3185, at p. 3127 — 14, 113*

Securities Act Release No. 33-2623, July 25, 1941,
11 F.R. 10964, 17 CFR § 231.2623
Vol. 1, CCH Sec.L.Rep. ¶ 3195 — passim, 114-17*
16-17*, 19*, 20*, 21*, 22*, 24*, 25*, 26*

Rule 10b-5, 17 CFR § 240.10b-5 — passim, 108*

Rule 10b-6, 17 CFR § 240.10b-6 — passim, 109-10*

Miscellaneous:

S. Rep. No. 1036, 83d Cong., 2d Sess. (1954) — 15

H.R. Rep. No. 1542, 83d Cong., 2d Sess. (1954) — 15

Hawkland, Sales & Bulk Sales, ABA/ALI Series Practicing Handbook (2d ed. 1958) — 83

NASD Emergency Rules of Fair Practice No. 70-2(II) — 84

Addendum A: Statutes, Regulations and Releases — 101*

Securities Act — 101-07*
Securities Exchange Act — 108-10*
Uniform Commercial Code — 111-12*

SEC Release No. 33-828 — 113*
SEC Release No. 33-2623 (General Counsel's Opinion) — 114-17*

Matter of Jaffee & Co. — 118-29*
Matter of Collins Securities Corp., — 130-45*

Addendum B: High and Low Bids and Spread June 1 through June 25, 1971 — 146

Addendum C: Actual Resales against Pink Sheet Quotes — 147

---

*Indicates quoted matter.

To be argued by
Reginald Leo Duff

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

THOMAS J. BYRNES and FRANCIS R. SANTANGELO,

Plaintiffs-Appellants,

-against-

FAULKNER, DAWKINS & SULLIVAN and SINGER & MACKIE, INC.,

Defendants-Appellees.

Dkt. 76-7259

FAULKNER, DAWKINS & SULLIVAN,

Counterclaim-Plaintiff, Appellee, Appellant,

-against-

THOMAS J. BYRNES and FRANCIS R. SANTANGELO,

Counterclaim-Defendants, Appellants, Appellees,

and

TOBEY & KIRK,

Counterclaim-Defendant-Appellee.

BRIEF OF THE PLAINTIFFS AND COUNTERCLAIM DEFENDANTS-APPELLANTS *

Preliminary Statement

Plaintiffs appeal, pursuant to 28 U.S.C. § 1291, from a final judgment of the United States District Court for the Southern District of New York, entered on an unreported decision by Hon. Henry F. Werker, U.S.D.J., dated February 26, 1976, CCH Sec.L.Rep. ¶ 95,463 (A-5-23), as amended (A-23-24). Plaintiffs

*Permission has been granted to file a brief not exceeding 100 pages.

appeal from the grant of summary judgment to defendant Faulkner, Dawkins & Sullivan ("Faulkner") on its Second Affirmative Defense, and from the denial of summary judgment to plaintiffs on Faulkner's First, Second, Third and Seventh Affirmative Defenses.

Plaintiffs also appeal from an order entered June 19, 1973, by Hon. Murray I. Gurfein, U.S.D.J., reported in 362 F.Supp. 864 (A-25-31), which, as amended (A-31-32), dismissed their original complaint (A-33-47) seeking a declaratory judgment of the legal insufficiency of what were denominated "defenses" under the Securities Exchange Act of 1934, 15 U.S.C. § 78 ("the Exchange Act"), and the Securities Act of 1933, 15 U.S.C. §§ 77a ff., ("the Securities Act").* These "defenses"----or claims to avoid the contracts of sale because of the alleged violations by plaintiffs or their broker, counterclaim-defendant Tobey & Kirk, of the Exchange Act and/or the Securities Act---had been asserted by both defendants in a state court action which had been commenced by plaintiffs for breach of two contracts of sale of stock of White Shield Corporation ("White Shield") by plaintiffs to defendants. The same "defenses" were repeated in the Court below.

---

*While dismissing plaintiffs' complaint for lack of subject matter jurisdiction, Judge Gurfein's decision held that the Court had subject matter jurisdiction of compulsory counterclaims which Faulkner had asserted under the Exchange Act. The Court therefore permitted plaintiffs to replead their dismissed declaratory judgment claim as a compulsory counterclaim to Faulkner's counterclaims, which invitation plaintiffs accepted (A-78-89). Since the other defendant, Singer & Mackie, Inc., had amended its answer to omit the counterclaims which it had initially asserted, the Court held that there was no jurisdiction as to that defendant and dismissed the complaint against it. Thus this aspect of the appeal relates primarily to plaintiffs' claim against Singer & Mackie.

Statement of Facts

Most of the facts have been stipulated (A99-111). Judge Werker's decision below involves only questions of law.

The present action arises out of two cancelled sales of White Shield securities by plaintiffs in June 1971---44,000 shares at $14 to Faulkner on June 7, 1971, and 1,500 shares to Singer & Mackie at prices between $13-1/8 and $13-3/8 on June 8, 1971. Although not part of plaintiffs' claim, it is also pertinent that on June 7, 1971 Faulkner resold 20,000 of the shares so purchased to two other market-makers, at an overall mark-up of $1,875. Of these, 15,000 shares were resold to Singer & Mackie at $14-1/8 (A-106, # 25).

By the respective settlement dates for these several transactions, the market price of White Shield stock had declined sharply (A-108), so that both Faulkner and Singer & Mackie faced large trading losses on their purchases. Faulkner refused to accept delivery of the shares delivered on plaintiffs' behalf, and agreed with its own vendees (including Singer & Mackie) to cancel its resales to them without penalty (A-106, # 26), and Faulkner's cancellation was followed on or about June 16, 1971 by Singer & Mackie's purported cancellation of its own purchase of 1,500 shares from plaintiffs' broker (A-61, ¶ 74).

At the time of Faulkner's cancellation, and during ensuing discussions between Faulkner's house counsel, Marc R. Green, Esq., and various attorneys representing Tobey & Kirk or the plaintiffs, the only reason assigned for the cancellation

(A-167, 402) was that the transaction violated Rule 10b-6, 17 CFR § 240.10b-6, as construed by a two-to-one majority of the Securities and Exchange Commission ("SEC" or "Commission") in Matter of Jaffee & Co., CCH Sec.L.Rep. ¶ 77,805 (1970)(hereinafter "Jaffee" or "the Jaffee Rule").*

In a nutshell, Jaffee held that a market-maker who purchases stock in a registered distribution thereby becomes a "participant" in the distribution, and by continuing his open-market purchases as part of his market-making operations, violates Rule 10b-6. Since Faulkner was a market-maker in the stock of White Shield, and plaintiffs were selling shareholders in a registered secondary distribution, Faulkner claimed that it could not lawfully consummate the transaction in suit.

Following the rejection of the securities by Faulkner and the failure of settlement discussions, plaintiffs resold the stock in a market already inundated by some 2,300,000 shares of White Shield stock added to the "float" by four registered secondary distributions in June 1971 (A-129, nt. 5). Plaintiffs

---

*The "Jaffee" Rule referred to herein and in Judge Werker's decision was not considered in this Court's affirmance and reversal of other aspects of the Commission's proceedings. Jaffee & Co. v. SEC, 446 F.2d 387 (2d Cir. 1971). The affirmance in this Court was as to an individual whose own testimony established conventional Rule 10b-6 violations as to which the "Jaffee Rule" was irrelevant. There were no similar violations of Rule 10b-6 in this case. Moreover, the parties in the Commission's Jaffee proceeding to whom the "Jaffee Rule" applied, viz. the market-maker (Greene & Co.---roughly corresponding to Faulkner and Singer & Mackie here), and the selling shareholders' "exclusive agent" (Lee & Co.---roughly corresponding to Tobey & Kirk here) did not appeal, so that the issues pertinent to this action were neither raised nor decided by this Court.

sustained an overall loss on the resales of $225,145.30, of which $219,180.79 was attributable to securities rejected by Faulkner, and $5,964.51 to securities rejected by Singer & Mackie.

The State Court Action

In due course plaintiffs commenced an action against the two defendants in the Supreme Court of New York, seeking recovery of their damages. Faulkner answered, ringing the changes with nine affirmative "defenses"---three alleging violations of the Exchange Act, three alleging violations of the Securities Act, and three---relating mostly to the amount of damages---invoking state law or NASD regulations respecting resales. Each of Faulkner's "defenses" was aped by Singer & Mackie.*

Because the "defenses" asserted under the Exchange Act and the Securities Act involved for the most part unprecedented interpretations of the two statutes, plaintiffs commenced the action below, seeking a declaratory judgment that the federal "defenses" were insufficient as a matter of law. No damages were sought (A-40-47), and the parties agreed to stay the state action pending a disposition in the federal court (A-111, # 31).

In the Court below both defendants reasserted the identical nine "defenses", augmenting them with three counterclaims. The First Counterclaim was for declaratory judgment of the sufficiency of the several "defenses"; the Second Counter-

---

*Notwithstanding that Singer & Mackie purchased its shares as agent rather than as principal (A-61, ¶ 72), so that Jaffee by its terms could not apply, its Fourth Defense duplicated Faulkner's.

claim charged a violation of Rule 10b-6 and sought compensatory and punitive damages (the latter ostensibly under state law); and the Third Counterclaim charged a violation of Rule 10b-5 and sought the identical compensatory and punitive damages. Singer & Mackie thereafter amended its Answer to eliminate its counterclaims for damages. Since Singer & Mackie's "defenses" exactly duplicate Faulkner's, we discuss only the Faulkner "defenses" as these were developed below.

Sword vs. Shield

Perhaps the single most interesting question---both from a jurisdictional standpoint and as a matter of statutory construction---is whether Faulkner's and Singer & Mackie's assertion of alleged violations of the securities laws by way of putative "defenses" to a contract action is properly the invocation of a "defense" which will not support federal subject matter jurisdiction, or is really the assertion of an affirmative right of action given by the statute to an aggrieved party, and whether the putative violations can be used as a shield even if they do not suffice as a sword, and whether the alleged violator can himself invoke the Court's subject matter jurisdiction to declare his non-culpability.

Both Judge Gurfein, in dismissing plaintiffs' complaint 362 F.Supp. at 867-68 (A-28-29), and Judge Werker, in denying plaintiffs the right to invoke the exculpatory protections of section 19(a) in connection with the violations of the Securities Act asserted in the Second and Third Defenses, CCH Sec.L.Rep.

¶ 95,463, at p. 99,347, 99,349-50 (A-13, 15-16), implicitly adopted Faulkner's unspoken assumption that a putative violation of the Act by plaintiffs may be asserted by way of defense to an action for breach of contract, as a matter of public policy, and that the allegedly injured party is not thereby invoking an affirmative right granted by the statute. Judge Werker applied this rationale by refusing to permit plaintiffs to invoke the exculpatory provisions of section 19(a), 15 U.S.C. § 77s(a), because plaintiffs were suing rather than being sued and, by its terms, the section applies only to "liabilities" created under the Act. Ibid. Judge Gurfein adopted it when he invoked cases which hold that an anticipated federal "defense" cannot support federal jurisdiction, loc.cit.

Yet the unspoken premise of both District Judges appears to be wrong from the start. We discuss Judge Werker's treatment of section 19(a) in Point III hereof, and Judge Gurfein's dismissal of the complaint in Point VI.

Questions Presented

1. Did the Court below give sufficient consideration to the legislative history, policy and purposes of the Securities Act of 1933 in holding that section 2(10) thereof applies to a broker's "comparison," and in granting summary judgment to Faulkner on the Second Affirmative Defense and denying summary judgment to plaintiffs thereon?

Plaintiffs respectfully submit that the Court below erred in so ruling, and did not sufficiently consider the legislative history, purpose and policy of the Securities Act.

2. Did the Court below err in denying summary judgment to plaintiffs on the Third Affirmative Defense because Tobey & Kirk was not an "underwriter" as a matter of law, and because the failure to identify it as such, by name, in the prospectus was not a material omission since the legal conclusion was stated and Faulkner knew the facts?

Plaintiffs respectfully submit that the Court below did err in so holding.

3. Did the Court below err in holding that plaintiffs could not invoke the exculpatory provisions of section 19(a) with respect to the Second and Third Affirmative Defenses because they were suing rather than being sued, and because of putative factual issues?

Plaintiffs respectfully submit that the Court erred in so holding.

4. In denying summary judgment to plaintiffs on the First Affirmative Defense invoking Rule 10b-5, did the Court below fail to give due consideration to the relative states of the parties' knowledge and access to the publicly available facts, to the sufficiency in the circumstances of plaintiffs' actual and admitted disclosures that their stock was in registration, and to the admitted failure of Faulkner to ascertain publicly-available facts of which, as a market-maker, it was required to have knowledge, and thus apply an impermissibly stringent disclosure standard?

Plaintiffs respectfully submit that the Court below did not sufficiently weigh these factors, and so imposed an impermissibly stringent requirement of disclosure upon plaintiffs, denying summary judgment because under such a standard there were triable issues of fact.

5. Did the Court below err in denying summary judgment to plaintiffs with respect to the Seventh Affirmative Defense, by improperly imposing upon them the obligation of demonstrating the "reasonableness" of their resales of the rejected White Shield stock, whereas the real issue before the Court was whether Faulkner was prejudiced by the delay in commencing and completing the resales of the rejected securities, on which Faulkner had the burden of proof but failed to adduce any evidence as required by FRCP 56(e).

Plaintiffs respectfully submit that the Court below improperly declined to enter summary judgment for plaintiffs on the Seventh Affirmative Defense.

6. Did the Court below err in dismissing plaintiffs' plenary complaint for declaratory judgment because of the lack of subject matter jurisdiction?

Plaintiffs respectfully submit that the Court below had subject matter jurisdiction of plaintiffs' complaint for declaratory judgment, and that the federal "defenses" asserted by both defendants were in fact claims for affirmative relief under the Securities Act and the Exchange Act, which permitted plaintiffs to invoke the District Court's subject matter jurisdiction con-

ferred by those statutes by way of an action for declaratory judgment of non-liability thereunder; and that the Court below erred in dismissing the complaint for lack of subject matter jurisdiction.

POINT I

IN GRANTING SUMMARY JUDGMENT TO FAULKNER ON THE SECOND AFFIRMATIVE DEFENSE, AND IN DENYING SUMMARY JUDGMENT TO PLAINTIFFS THEREON, THE COURT BELOW GAVE INSUFFICIENT WEIGHT TO THE LEGISLATIVE HISTORY, PURPOSE AND POLICY OF THE SECURITIES ACT

The Court below sustained Faulkner's Second Affirmative Defense, which contends that by failing to deliver a copy of the prospectus with the "comparison"* which plaintiffs' broker, Tobey & Kirk, exchanged with Faulkner on the date of the trade, Tobey & Kirk (and through it the plaintiffs) violated section 5(b)(1) of the Securities Act, 15 U.S.C. § 77e(b)(1), by delivering to Faulkner and Singer & Mackie a "prospectus" which does not comply with the Act. The argument is that by virtue of section 2(10), 15 U.S.C. § 77b(10), the "comparison" itself is deemed to be a "prospectus" because it literally "confirms" the sale of a security, does not contain all of the information which is required in (and was not accompanied or preceded by) a statutory prospectus.

---

*As noted by Judge Werker, CCH Sec.L.Rep. ¶ 95,463, at p. 99,343 nt. 5 (A-9), the term "comparison" as used herein relates to a writing exchanged between broker-dealers, while the term "confirmation" is used to refer to communications sent by a broker-dealer to his customer. Section 2(10) plainly applies to "confirmations" to a customer. The legal question is whether it also applies to a "comparison."

Obviously a "comparison" literally "confirms" the sale of a security, and that is one of its purposes. However, section 2(10) is designed only to assure that formal prospectuses are delivered when other provisions of the Act require delivery, and it was never contemplated that such prospectuses must be delivered with an inter-broker "comparison," so that no statutory purpose is served by reading section 2(10) so to apply.

Any consideration of the Second Affirmative Defense requires a thorough examination of the purpose and policies underlying the Securities Act as a whole, and not blind reliance upon the naked language of what is no more than a definitional section. We therefore commence our analysis with a brief examination of the Securities Act, and the place and role of sections 5(b)(1) and 2(10) therein.

The Statutory Framework

The Securities Act of 1933 is a rather straightforward statute centering on section 5, which requires that securities be sold only pursuant to an effective registration statement and that written offers or solicitations to purchase be made only by means of prospectuses containing information prescribed in sections 7, 10 and 27 of the Act, 15 U.S.C. §§ 77g, 77j, 77aa.

The registration and prospectus-delivery requirements of section 5 are subject to a number of exemptions contained in section 4 of the Act, 15 U.S.C. § 77d, which exempts from the otherwise all-inclusive application of section 5 four categories of transaction: These are

(1) transactions by any person other than an issuer, underwriter, or dealer;

(2) transactions by an issuer not involving any public offering ("the private placement exemption");

(3) certain transactions by "dealers"; and

(4) unsolicited brokers' transactions executed on a securities exchange or in the over-the-counter market.

Relevant to section 5 are definitions contained in section 2 of the Act, 15 U.S.C. § 77b, all of which are introduced by the caveat "unless the context otherwise requires." Section 2(10) broadly defines "prospectus" to include any writing "which offers any security for sale or confirms the sale of any security."

The prohibitions of section 5 are accompanied by express remedies contained in sections 11 and 12 of the Act, 15 U.S.C. §§ 77k, 77l, which give to purchasers of securities certain specified remedies of rescission or damages, subject to the short statute of limitations contained in section 13, 15 U.S.C. § 77m.

Contrary to what appears to have been the implicit ratio decidendi of the Court below on the Second Affirmative Defense, the Securities Act is not concerned primarily or even in passing with the regulation of writings which "confirm the sale of any security." The Act as a whole is directed to the regulation of offers and sales of securities. In order to prevent evasions of its mandates, it also proscribes the use of writings which "confirm" the sale of a security where that prohibition

advances the overall statutory purpose. However, where the statutory purpose is not advanced by such a reading, the Act and its sanctions should not be read to apply to mere "confirmations."

No doubt the burden of proving that "the context otherwise requires" is upon the party seeking to avoid the explicit language of the statute, Exchange National Bank v. Touche Ross & Co., ___ F.2d ___, CCH Sec.L.Rep. ¶ 95,614, pp. 90,063, 90,059 (2d Cir. 1976), but the cited decision necessarily eschews the suggestion that the statutory language is irrebuttable.

There has been no prior judicial authority on the question. However, the legislative history, the examination of the statutory purpose and policy all suggest that the Court below misconceived the purpose of section 2(10), and misapplied it to brokers' "comparisons" by exalting the naked language of the section as amended.

(a) The History of § 2(10)---both before and after the amendment of 1954---does not support the application of § 2(10) to brokers' "comparisons"

The analysis of the applicability of section 2(10) to brokers' "comparisons" must commence with the statute as originally enacted in 1933. The original section 2(10) of the Act broadly defined the term "prospectus" to include any writing which "offers" a security for sale, but did not specifically mention "confirmations":

> "The term 'prospectus' means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio, which offers any security for sale; except that (a) a communication shall not be deemed a prospectus if it is proved that prior to such communication a written prospectus meeting the requirements of section 10 was received, by the person to whom the communication was made, [from the person making such communication or his principal]*, . . ."

Patently the original version of section 2(10) did no more than to include within the term "prospectus" all offering or selling literature, unless accompanied or preceded by a statutory prospectus. So much was recognized by the Commission in Release No. 33-828, June 4, 1936, 11 F.R. 10957, 17 CFR § 231.828 (Vol. I, CCH Sec.L.Rep. ¶ 3185, at p. 3127).

In 1941 the Commission's General Counsel issued in an Opinion which extended the reach of section 2(10) by stating that "the term 'prospectus' is defined in the Act broadly to include within its meaning an ordinary confirmation." Securities Act Release No. 33-2623, July 25, 1941, 11 F.R. 10964, 17 CFR § 231.2623, Vol. 1, CCH Sec.L.Rep. ¶ 3195, at p. 3129. The interpretation was addressed to a dealer's oral offer to sell registered securities to his customer which was followed up by a written confirmation of the offer and acceptance.

In 1954 section 2(10) was amended to include within the definition of "prospectus" a writing which "confirms the sale of any security." The Committee Reports of both Houses of Congress explicitly refer to the General Counsel's 1941 Opinion and state

---

*The language in square brackets was deleted by the 1954 amendment to § 2(10). It affects certain conclusions regarding the section, but is not pertinent to the present appeal.

(S.Rep. No. 1036 at p. 12; H.R. Rep. No. 1542 at p. 21, 83d Cong., 2d Sess. (1954)), that the amendment was adopted in order to avoid the implied repeal of the General Counsel's 1941 "settled interpretation" of the original text of section 2(10).

But the "settled interpretation" equating a "confirmation" with a "prospectus," would not have required the delivery of a prospectus with Tobey & Kirk's "comparison," as is demonstrated by one of the eleven hypothetical Questions and Answers which make up the bulk of the General Counsel's Opinion, and is indistinguishable from the facts in the transactions in suit.

Moreover, in the forty-three years since its adoption, and the thirty-five years since the General Counsel first construed section 2(10) to apply to writings which "confirm the sale of any security," neither the Commission nor (until now) any Court has even intimated that section 2(10) might apply to a broker's "comparison." The reason is not hard to find. As we have suggested above, the Act does not seek to regulate "confirmations" as such, and does not do so except insofar as may be necessary to its principal purpose of requiring offers and sales of securities to be made by means of a statutory prospectus. By hypothesis, brokers' "comparisons" exchanged after a sale, while literally "confirming" the sale, seldom if ever involve an "offer" or are used to circumvent the principal statutory prohibition.

The General Counsel's 1941 Opinion had been given in response to a request for guidance with respect to an AT&T "registration statement which became effective under the Securities Act

on July 15, 1941." (Vol. I, CCH Sec.L.Rep. ¶ 3195, at p. 3128). The Opinion commenced by observing (id., ¶ 3197, pp. 3128-29) that the statute drew no fine distinction between a formal offer and a solicitation of an order to buy, noting that section 2(10) would apply to:

> "a circular distributed by a broker or dealer to his customers, describing the debentures and the rights and suggesting that he would be glad to receive and execute orders after the statement became effective, was no less a violation of the statute than a circular inviting the immediate submission of orders before the effective date. The same would be true even if the circular carried a 'hedge clause' specifically disclaiming any intent to solicit orders. If the circular in fact constituted a solicitation of orders it could not be brought within the law by mere formal disclaimers." (Emphasis added).

This reminder that the statute is concerned with substance was then followed by a brief explanation of the prospectus delivery requirements, and that statement was followed by a caveat that the statutory term "prospectus" is not to be restricted solely to the formal prospectus defined in section 10, but applies as well to "any document which is designed to procure orders for a security, or to effectuate the disposition of a security," (id., ¶ 3198, at p. 3129):

> "In applying these principles to particular situations, brokers and dealers should appreciate that the term 'prospectus' as used in the Securities Act covers more than the kind of formal document which the layman ordinarily has in mind when he uses the term. Under the Act a 'prospectus' includes every kind of written communication which attempts or offers to dispose of, or solicits an offer to buy, a security for value. If the term 'prospectus' is construed in accordance with its language and spirit, it must in my opinion be read to cover any document which is designed to procure orders for a security, or to effectuate the disposition

of a security, whether or not the document purports on its face to offer the security for sale, or otherwise to dispose of it for value." (Emphasis added).

The General Counsel then applied these general principles to eleven hypothetical Questions and Answers, all based upon the AT&T offering to which the inquiry had been addressed. It is in these Questions and Answers that the first articulation appears that a document which "confirms" the sale of a security may also qualify as a "prospectus" even under the original text of section 2(10), if the "confirmation" is an indispensable part of the solicitation.

As we shall emphasize below, each of the General Counsel's Answers to the eleven hypothetical Questions can be explained by reference to specific provisions of the Act which exempt transactions from the prospectus-delivery requirements of section 5, and we interject what we believe to be the appropriate exemptive provisions in quoting the several Questions and Answers.*

This correlation of each of the General Counsel's Answers with the existence or unavailability of a specific exemption from section 5 is fundamental. Judge Werker seemed to treat section 2(10) as though it were wholly independent of section 5, holding it applied to any writing "irrespective of the status of the transaction in which it is used." CCH Sec.L.Rep. ¶ 95,463, at p. 99,345 (A-11). The General Counsel's Opinion,

---

*It is not inappropriate to supply the presumed statutory underpinning for each of the General Counsel's conclusions since the Opinion itself was intended to provide guidance "in as non-technical a fashion as possible," and offered to any reader to provide "more detailed information as to the statutory basis for the answers . . . given". CCH Sec.L.Rep., supra, at p. 3131.

reinforced by Matter of Collins Securities Corp., Release No. 11,766, CCH Sec.L.Rep. ¶ 80,327 (1975), makes clear that the applicability of section 2(10) itself depends upon whether or not section 5 is applicable to the transaction.

Before turning to the General Counsel's Questions and Answers, we stress some subtleties in the Opinion. Thus, Questions ## 1 through 5 hypothesize that John Doe is a "dealer"*---i.e., a broker-dealer selling the securities for his own account, whereas in Questions ## 6 through 11 he is a "broker"---i.e., an agent for his customers. Similarly, in all Questions other than ## 8 and 10, the issue is whether John Doe, the selling "broker" or "dealer", is required to deliver a prospectus to his own customer, while in Questions ## 8 and 10 the inquiry is as to his duty to deliver a prospectus to another "dealer" purchasing for his own account.

We believe that Question # 8 is indistinguishable from the facts of the case at Bar---the present plaintiffs corresponding to Richard Roe, the selling shareholder; Tobey & Kirk corresponding to John Doe, the selling "broker"; and Faulkner and Singer & Mackie corresponding to Henry Hoe, the "dealer" purchasing the securities for his own account.

---

*We note that § 2(12) of the 1933 Act, 15 U.S.C. § 77b(12), only defines "dealer" and does so in terms which would include a "broker" as well. Our distinction between the two functions is reflected in §§ 3(a)(4) and (5) of the Exchange Act, 15 U.S.C. §§ 78c(a)(4) and (5), and parallels the General Counsel's usage. The two statutes are, of course, in pari materia. Globus v. Law Research Service, Inc., 418 F.2d 1276, 1286 (2d Cir. 1969).

The General Counsel's Question and Answer # 1 hypothesizes an offering letter from a "dealer" ---i.e., a broker-dealer purchasing or selling for his own account---which clearly falls within the explicit language of the original section 2(10):

> "Question 1. John Doe, a dealer, writes a letter to Richard Roe, one of his customers, offering him warrants, on a when-issued basis, for ten $100 debentures. Must John Doe send a copy of the formal prospectus with his letter?
>
> "Answer. Yes. John Doe's letter itself falls within the broad definition of 'prospectus' in the Act. As such, it must, in order to comply with the Act, either be in the form of the formal prospectus---which it obviously is not---or else be preceded or accompanied by a formal prospectus."

Accord, Diskin v. Lomasney & Co., 452 F.2d 871, 875 (2d Cir. 1971). The transaction is not exempt from the registration and prospectus-delivery requirements of the Act under sections 4(1) or 4(4) because, by hypothesis, John Doe is a "dealer." Since the solicitation is hypothesized to be on a "when issued" basis, and so was necessarily made before the effective date of the registration statement, it is not exempt under section 4(3).

The "settled interpretation" which the Congress did not wish to repeal by implication is contained in Question and Answer # 2, which deals with the selling dealer's oral offer followed by a written "confirmation" to his customer:

> "Question 2. Instead of writing a letter to Richard Roe, John Doe calls him on the telephone and offers him the warrants. Richard Roe accepts; and John Doe thereupon mails him a confirmation of the sale. Must John Doe send a copy of the formal prospectus with the confirmation?

"Answer. Yes. The term 'prospectus' is defined in the Act broadly to include within its meaning an ordinary confirmation; and since the confirmation is not itself a formal prospectus, it, like the offering letter in Question 1, must be accompanied or preceded by a formal prospectus." (Emphasis added).

Nothing in the literal text of section 2(10), as it then stood, dictated this conclusion. However, the General Counsel's reading plainly advanced the statutory purpose because the written "confirmation" was an integral part of the dealer's oral "offer" to his customer---indistinguishable in principle or effect from the written offer considered in Question # 1. It thus played an intrinsic role in the solicitation of a customer's order which the Act requires to be made by means of a formal prospectus, and, as this Court said in Diskin v. Lomasney & Co., supra, 452 F.2d at 876, "Very likely Congress thought a better time for meaningful prospectus reading was at the time of the offer rather than in the context of confirmation and demand for payment."

The first five* Questions and Answers dealt with offers to sell (or solicitations of orders to buy) made by a dealer to

---

*We omit quotation of Questions and Answers ## 3, 4 and 5. We omit Question and Answer # 3 because the 1954 amendment to § 2(10) makes it only of historical interest by eliminating a writing from the definition of "prospectus" if the purchaser has received a statutory prospectus from someone other than the seller. See note, p. 14, ante.

Questions and Answers ## 4 and 5, deal with the duty, imposed by § 5(b)(2), to deliver prospectuses with the securities. Since the seller was hypothesized to be a "dealer," the §§ 4(1) and 4(4) exemptions did not apply. Since Question # 4 hypothesized a transaction within 20 days of the effective date of the registration statement, the § 4(3) "dealer's" exemption also was not applicable. In Question # 5, the purchaser already had a prospectus, so that the dealer was not required to deliver another copy. See note, p. 14, ante.

his own customer. Question # 6 for the first time describes John Doe as a "broker" rather than a "dealer," and hypothesizes an unsolicited brokerage order placed by the broker's customer. On these facts the General Counsel concluded that there was no prospectus delivery requirement:

> "Question 6. John Doe, a broker, receives an unsolicited telephone call from Richard Roe, asking him to purchase for Richard Roe's account warrants for ten $100 debentures. John Does does so and sends them to Richard Roe by mail. Must he send a copy of the prospectus with the warrants?
>
> "Answer. No. The prospectus requirements of the Act do not apply to unsolicited brokers' transactions, whether executed on an exchange or over the counter."

The Answer to Question # 6 does not flow from the text of section 2(10) standing alone, or even from section 5, but from the exemption contained in what is now section 4(4) of the Act, 15 U.S.C. § 77d(4), which exempts unsolicited brokers' transactions executed on a securities exchange or in the over-the-counter market, so that "the provisions of section 5 shall not apply" to the transaction. Here a prospectus is unnecessary under either subdivision of section 5(b) because there is no element of solicitation by the "seller" or his broker, and the situation is one to which the exemption properly applies. Yet, there can be little doubt that John Doe's "confirmation" to Richard Roe, his customer, literally falls the language of section 2(10).

Similar in its implications is Question # 7, relating to an unsolicited sell order given by the customer to his "broker:"

"Question 7. Richard Roe telephones John Doe, his broker, and states that he has certain warrants which he would like John Doe to sell for his account. John Doe does so, and sends him a confirmation of the transaction. Must John Doe at the same time send him a copy of the prospectus?

"Answer. No. In confirming a sell order on a brokerage basis, John Doe is not within the prospectus requirements of the Act."

Here again the "confirmation" considered in Question # 7 literally "confirms the sale of any security." Nevertheless, it is axiomatic that the Securities Act affords no rights or remedies to sellers of securities.

Up to this point we have been considering the obligation of a broker (Questions ## 1 through 5) or a dealer (Questions ## 6 and 7) to deliver a prospectus to his own customer. At this point the Questions and Answers shift to an area bearing more closely upon the situation in suit---the obligation of a selling broker to deliver a prospectus to the purchasing dealer, who is hypothesized to be purchasing the security for his own account:

"Question 8. Pursuant to the sell order received in Question 7, John Doe sells Richard Roe's warrants to Henry Hoe, another dealer, who purchases for his own account. Must John Doe, in confirming the sale to Henry Hoe, or in delivering the warrants to him, send him a copy of the prospectus?

"Answer. No. John Doe, in making the sale, is completing the execution of an unsolicited brokerage order, and therefore is exempt from the prospectus requirements."

The General Counsel's conclusion manifestly is correct, but for the wrong reasons. In terms he invokes the section 4(4) unsoliciated broker's exemption, which more properly applies where

the purchaser has not been solicited. The given facts would support a section 4(1) exemption, as a transaction by a person who is not an "issuer, underwriter or dealer." However, Question # 8 does not disclose whether Henry Hoe, the purchasing dealer, was a "market-maker" who had inserted bids in the Pink Sheets. If he were, that fact might support the section 4(4) exemption since there would be no element of solicitation in John Doe's calling him to get a quote and an offer. Accord, CCH ¶ 95,463, at p. 99,345 (A-11); cf., Rule 154, 17 CFR § 230.154 (1954).

Continuing with Question # 9, it is identical to Question # 7, except that the broker solicited the sell order. Both Answers hold that a broker need not deliver a prospectus with his confirmation, regardless of whether the transaction was solicited or not:

> "Question 9. John Doe writes to his customer, Richard Roe, whom he knows to be a stockholder of American Telephone and Telegraph Company and offers to sell for him the warrants he has received. Must John Doe send Richard Roe a formal prospectus with his letter?
>
> "Answer. No. Since he is offering to sell for him, not to him."

Because Question # 10 also assumes the facts of Question # 9---that the broker solicited the sell order from his customer, the General Counsel's Answer is different from the Answer to the otherwise indistinguishable Question # 8, holding that the selling broker must deliver a prospectus to the purchasing dealer with the securities:

"Question 10. As a result of the letter described in Question 9, Richard Roe gives John Doe a sell order, and John Doe sells the rights to Henry Hoe. When he mails the warrants to Henry Hoe, must he send a copy of the prospectus with them?

"Answer. Yes. The transaction, although on a brokerage basis, results from a solicitation, and consequently the prospectus requirements are applicable to John Doe's sale to Henry Hoe."

Plaintiffs submit that Answer # 10 is wrong because the General Counsel incorrectly looked to the section 4(4) exemption in Questions ## 8 and 10. This rationale is wrong because if a prospectus is required to be delivered the right to receive it is the buyer's right and should not depend upon whether the selling stockholder gave his broker an unsolicited "sell" order as in Question # 8, or was himself solicited to sell as in Question # 10. The section 4(4) exemption should be construed to apply only to a transaction in which the buyer has not been solicited.

On the other hand, treating Question # 8 as one involving the section 4(1) exemption conforms to the policy of the Act as a whole. The Act requires that sales of securities by an issuer or a controlling person be by prospectus. If the seller is not a control person, his broker is not a statutory "underwriter" under section 2(11), and the sale should be exempt from the provisions of section 5 under section 4(1), whether or not the broker solicited the sell order from his customer or was himself asked to sell the stock. If, on the other hand, the selling shareholder is a control person, his broker is a statutory "underwriter" and should be required to deliver a prospectus

regardless of whether the impetus to sell originated with him or with his customer. Thus we agree with Answer # 8, but not with Answer # 10.

The General Counsel's Opinion concludes with Question and Answer # 11 which is identical to Question and Answer # 1, except that John Doe is a "broker" rather than a "dealer" and so offers "to purchase rights for" Richard Roe's account instead of offering "to sell the warrants to" Richard Roe on a "when issued" basis. The Answers to both Questions are necessarily the same because the broker's exemption of section 4(4) by its terms does not apply to "the solicitation of such orders" to purchase:

> "Question 11. John Doe writes a letter to Richard Roe, his customer, offering to purchase rights for his account. Must John Doe enclose in his letter a copy of the prospectus?
>
> "Answer. Yes. Even though John Doe acts as broker in the transaction, he is soliciting an offer to buy, and is therefore subject to the prospectus requirements of the Act."

Application of General Counsel's Opinion

We believe that the case at Bar is governed by Answer # 8, on authority of which it is exempt from the prospectus delivery requirements, either on the General Counsel's or our own rationale of section 4(4), or on our suggestion that the proper exemption is section 4(1).

If we are right that the proper exemption for Questions ## 8 and 10 is section 4(1), it seems quite clear that Tobey & Kirk was neither "an issuer, underwriter, or dealer" (a subject more fully discussed in Point II hereof). Nevertheless although

the Court below denied summary judgment to either party on the Third Defense because it believed the facts were in dispute as to whether Tobey & Kirk was an "underwriter," CCH Sec.L.Rep. ¶ 95,463, at p. 99,349 (A-15), by granting summary judgment to Faulkner on the Second Defense the Court below seems to have resolved that question against plaintiffs and contrary to the facts of record.

If the correct exemptive provision be section 4(4)---based on the relationship of the selling shareholder and his broker---the fact is stipulated that plaintiffs asked Tobey & Kirk to sell their stock once the registration statement became effective (A-101-02, # 3), so that on the General Counsel's rationale the section 4(4) exemption would exempt the transaction in suit from the prospectus delivery requirements. Moreover, our alternative section 4(4) rationale also exempts the transaction in suit since it is stipulated (A-102, ## 7-8) that Faulkner published bids in the Pink Sheets and that Tobey & Kirk's inquiry was a response to those bids (A-103, # 11), so that, as between them it was an unsolicited transaction. Cf., id., p. 99,345 (A-11).

Developments subsequent to 1941 also confirm our conclusion that the prospectus delivery requirements do not apply in the present action. The 1954 amendment to section 2(10) eliminated the prior obligation to deliver a prospectus even if the buyer already has a copy (see ante, p. 14, nt.). When this fact is coupled with the Commission's decision in Matter of Jaffee & Co., CCH Sec.L.Rep. ¶ 77,805, at p. 83,858 (1970), which seems to

require a market-maker to obtain copies of a prospectus once he learns of a pending distribution in a security in which he is making a market, Tobey & Kirk could reasonably have assumed Faulkner's prior possession of a prospectus.

From the foregoing consideration of the General Counsel's 1941 Opinion, which was subsequently enacted into positive law, it should be obvious that very little turns upon the existence in the present section 2(10) of the words "or confirms the sale of any security," upon which the decision below is entirely dependent. Absent those words, a dealer's written confirmation of an oral offer to his customer qualified as a "prospectus" because the statute must be "construed in accordance with its language and spirit" (CCH ¶ 3198, at p. 3129).

On the General Counsel's overall exposition, section 2(10) comes into play only in those offering or soliciting situations in which a prospectus is required to be delivered under section 5 <u>because</u> none of the section 4 exemptions applies. There is no other explanation for the Answers to Questions ## 6, 7, 8 and 9---in each of which the "confirmation" or "comparison" literally "confirms the sale of any security."

The conclusion which necessarily flows from these now legislatively sanctioned interpretations of the statute is that the broad definition of "prospectus" contained in § 2(10), which was designed to prevent the evasion of the requirement of section 5(b)(1) that purchase orders be solicited only by means of statutory prospectuses, was not intended to be read with strangulating

literalness to apply to a written communication---like the exchange of brokers' "comparisons"---which cannot be used to evade the statutory mandate that securities be offered or sold only by means of a statutory prospectus. In holding otherwise, the Court below erred.

(b) The Court below applied improper standards of construction

This appears to be the first reported case to have considered the applicability of section 2(10) to a broker's "comparison." Lacking prior relevant judicial authority the District Court's task of reconciling the broad language of section 2(10) with the statutory framework, legislative history and purpose of the Securities Act was not aided by the Commission's "strained" reading of the law, as amicus below, CCH ¶ 95,463, at p. 99,353 nt. 26 (A-19), some inconsistent with its own decisions. In the end, the Court ignored statutory history and purpose, granting summary judgment on the basis of the naked language of section 2(10), as amended.

The Court below correctly commenced the inquiry by stating the question before it, but immediately lapsed into its obsession with the literal language of section 2(10), CCH Sec.L. Rep. ¶ 95,463, at p. 99,343 (A-9):

> "The real issue is whether the comparison is a prospectus at all such that the requirement in section 5(b) is even applicable. Section 77b(10) of 15 U.S.C. defines the term prospectus as 'any * * * communication written * * * which * * * confirms the sale of any security.' Taken literally, the statute[,] which is broad and inclusive, would seem to include a comparison sent by one broker to another, confirming the sale of a security."

The Court below implicitly rejected plaintiffs' contention that the analysis must commence with section 2(10) as originally adopted in 1933, and that the General Counsel's 1941 Opinion is dispositive on the meaning of the 1954 amendment. Although the Court did examine the legislative history, it seems never to have been able to get away from the fact that the section, as amended, applies to any writing "which confirms" the sale of a security, ibid.:

> "Those questions and answers do not provide the plaintiffs with the authority they seek for two reasons. They deal on their face with brokers' transactions as exempted from compliance with section 5 by the terms of section 4. The trade in question is not such a transaction. Second, the questions and answers relied upon have in part been superseded. CCH Fed.Sec.L.Rep. ¶ 3195 at 3131 n.2."

As to the Court's first reason for declining to follow the General Counsel's Opinion, it is clear that the Court below erred: Five of the General Counsel's Questions dealt with sales by "dealers." Moreover, Judge Werker's ipse dixit---that the trade in suit was "not such a transaction"---is incorrect. The facts of the present case are identical to the facts postulated in Question # 8 (A-100-01, # 3).

As to the Court's second ground, that some of the General Counsel's Questions and Answers have been superseded, that is, with respect, irrelevant. The General Counsel's "settled interpretation" was explicitly enacted into law by Congress. Any subsequent administrative relaxations of the prohibitions of the resulting statute cannot alter the meaning which was intended by

Congress when it adopted it, SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 199-200 (1963).

In rejecting our suggestion that Question # 8 is identical to the facts in the case at Bar both because plaintiffs had asked Tobey & Kirk to act for them in selling the stock and because any communication by Tobey & Kirk to Faulkner would not be a solicitation by Tobey & Kirk, but a response to Faulkner's own offer, as market-maker, to purchase White Shield stock, Judge Werker said, id., at p. 99,345 (A-11):

> "There is some support for this view had this transaction been conducted as a result of a customer's solicitation. Questions 7 through 10 indicate that where a broker sells securities to another broker at the request of the selling broker's customer, the transaction is unsolicited and therefore exempt from section 5.
>
> ". . .
>
> "There is a basic problem with this analysis, as applied to the instant case. Each of the releases which dealt with the concept of unsolicited orders did so in the context of a broker's exemption from section 5, not in consideration of whether a particular communication constituted a prospectus. Presumably, the sending of a document that clearly was a prospectus would not alter the determination as to whether or not a particular transaction was exempt. The point of these releases is that offering to sell a security to a broker who has inserted quotations in the sheets does not constitute a solicitation, regardless of the form in which that offer is made. That still does not contradict the language in section 2(10) that defines a prospectus as any written communication which confirms the sale of a security irrespective of the status of the transaction in which it is used. The Court therefore rejects the argument, based on questions 7 through 10 of the General Counsel's opinion that a comparison does not constitute a prospectus for the purposes of Section 2(10)."

This conclusion is untenable for a number of reasons. In the first place, the Court erred when it said that "Section 2(10) . . . defines a prospectus as any written communication which confirms . . . irrespective of the status of the transaction in which it is used." The status of the transaction under section 5 must be determinative of the applicability of section 2(10), Matter of Collins Securities Corp., CCH Sec.L.Rep. ¶ 80,327, at pp. 85,802-03 (1975) (quoted post, p. 33), because section 2(10) itself contains no prohibitions. Its sole office is to define the term "prospectus" for purposes of assuring compliance with section 5. Section 5, in turn, makes it unlawful, in situations to which it applies, to deliver a non-compliant prospectus. Since the opening clause of section 4 states that "The provisions of section 5 shall not apply to" a transaction exempted by section 4, the only conceivable rationalization of the General Counsel's Answers to Questions ## 6, 7 and 8 is that the transaction was exempt from section 5 by section 4, thereby rendering section 2(10) inapplicable.*

In holding that "Each of the releases . . . [dealt] in the context of a broker's exemption from section 5, not in consideration of whether a particular communication constituted a prospectus," Judge Werker's decision effectively creates an independent duty and liability under section 2(10), irrespective

---

*No doubt a sale made by means of a false "prospectus or oral communication" would be unlawful "irrespective of the status of the transaction" under § 5, because § 12(2) explicitly makes it so, not because the false statement is a "prospectus" under § 2(10). There is no suggestion that Tobey & Kirk's "comparison" "includes an untrue statement of a material fact or omits to state a material fact" required to be stated therein.

of section 5. The decision below thus ignores the opening clause of section 2, which states that the definitions apply "unless the context otherwise requires." Manifestly, where section 5 does not apply "the context otherwise requires."

Judge Werker concedes in the last-quoted paragraph that "offering to sell a security to a broker who has inserted quotations in the sheets does not constitute a solicitation, regardless of the form in which that offer is made," because it is in response to an offer to buy and so exempt under section 4 of the Act, no prospectus need be delivered to such dealer by the seller (Question # 8; Rule 154(d), 17 CFR § 230.154(d)(1954)). Yet the Court below assumed that if the sale to a market-maker is accomplished through another broker---who is himself required to send a "comparison"---the "or confirms" language of section 2(10) reverses that conclusion, and creates an independent duty to deliver the prospectus with the "comparison," making the prospectus delivery requirement independent of the rest of the Securities Act.

Conceding that every "confirmation" or "comparison" literally falls within section 2(10), the inquiry must necessarily be whether statutory policy requires that the writing be accompanied or preceded by a prospectus. If so, the failure to send the statutory prospectus violates section 5(b) because section 2(10) makes the "confirmation" a non-complying prospectus. If no prospectus is required to be delivered by section 5, section 2(10) should be wholly irrelevant although literally encompassing the writing.

That was the implicit rationale of the General Counsel in Question and Answer # 8, and it was the explicit holding of the Commission in Matter of Collins Securities Corp., Release # 11,766, CCH Sec.L.Rep. ¶ 80,327 at pp. 85,802-03 (Oct. 23, 1975), in which the Commission held that the insertion of bids in the Pink Sheets was not a "prospectus" under section 2(10):

> "This novel, and on its face startling proposition, finds some verbal support in the broad language of 2(10) which refers to any ' * * * communication, written or by radio or television, which offers any security for sale. * * *' However, it ignores some 40 years of history, goes beyond the statutory purpose, does nothing to serve that purpose, and would create unnecessary complications in the trading markets. Section 5(b) of the Act has two principal purposes: first, to insure that buyers of registered securities get the statutory prospectus and, secondly, to make sure that selling literature and other offering material is used only when it has been preceded by a statutory prospectus so that people will not be influenced by such solicitation to buy before they see the prospectus. The proposition with respect to the pink sheets, which would extend to NASDAQ or any other quotation system, would not further the first purpose and is only marginally applicable to the second. . . ." (Emphasis added).

The Court below wholly failed to consider the pertinent holding of Collins that it is the "purpose" of section 5, and not the existence of "some verbal support" in the language of section 2(10), which determines whether a duty exists to deliver a prospectus with a given "writing."

Finally we directed the Court's attention to language in the Senate Report which supported our view that there was no need to stretch section 2(10) to apply to a comparison because the purpose of the statute is to protect the investing public and not broker-dealers. The Court rejected the additional legislative

support in favor of what it deemed to be the "unambiguous language of the statute," initially because of a typographical error in its opinion. Thus, the Court said, CCH Sec.L.Rep. at p. 99,345 (A-11):

> "There is one statement, however, in the Senate Reports cited above that lends stronger support to the position taken by the plaintiffs that the comparison sent by Tobey & Kirk to Faulkner is not to be deemed a prospectus for purposes of the 1933 Act. . . . 'Section 5(b) of the Securities Act requires that all persons, unless exempt, use prospectuses in connection with the sale to the public of a registered security.' S.Rep. No. 1036, 83d Cong., 2d Sess. 6 (1954)(emphasis added [by the Court below]). It can certainly be argued that that is a recognition, at least by the Committee on Banking and Commerce, as constituted on February 25, 1964 [sic; 1954], that the prospectus delivery requirement in section 5(b)(1) was not intended to include comparisons exchanged by brokers. Nonetheless, this is insufficient authority to counteract what is otherwise clear statutory language."

Obviously the interpretation of a 1954 amendment by a 1964 Senate Committee would be of marginal, if any, relevance in determining what had been intended in 1954, cf., SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 199-200 (1963). However, the interpretation of a statute by the very Committee which sent it to the floor of the Senate is fundamental to its construction. On reargument the Court below corrected the typographical error (A-23) but not its conclusion.

Conspicuously absent from the Court's discussion of the Second Affirmative Defense is any reference to any statutory purpose or policy which the literal reading of section 2(10) would advance.

The amicus made a lame effort to supply a "purpose" for the literal reading of the statute---by suggesting that section 2(10) was designed to "supply a means of complying with the statute of frauds" (Amicus Memo., pp. 41-43, nt. 43). The contention is frivolous. No writing would have been required from plaintiffs had they dealt directly with Faulkner, instead of through their own broker. Both defendants themselves demonstrated that the Statute of Frauds rationale is spurious: Faulkner returned the securities marked "DK"---i.e, "don't know transaction" (A-103, # 15), while Singer & Mackie NASD Form 801, "Notice of Reclamation or Rejection," purporting to cancel the trade (A-107, # 27, A-205, # 18).

As the Collins decision (quoted ante, p. 33), makes plain, it is not the ability to find "some verbal support in the broad language of [section] 2(10)" which determines whether a writing is a non-compliant prospectus, but whether it serves the purposes of section 5(b) of the Act to do so. Examining the two statutory "purposes" of section 5(b) articulated in Collins, it is plain that neither will be served by applying section 2(10) to brokers' "comparisons" merely because there is "some verbal support in the broad language of 2(10)" for such a reading.

As to the first statutory purpose of section 5(b)---"to insure that buyers . . . get the statutory prospectus"---the Court's reading of section 2(10) will not "insure" that any member of the investing public, for whose protection the Securities

Act was admittedly adopted, will receive a copy of the statutory prospectus a single day sooner than normal: If the purchase is unsolicited, the customer is not entitled to receive a prospectus from his broker under section 4(4)(Question and Answer # 6, quoted ante, p. 21). If the purchase was solicited the purchaser's broker has an independent duty to deliver a prospectus, Diskin v. Lomasney & Co., supra, 452 F.2d 871, 875-76 (2d Cir. 1971), which should be sent with the "confirmation" on the day of sale, when the "comparison" is also sent, so that the purchasing broker will most likely not have received the selling broker's "comparison" and prospectus by the time he confirms to his owncustomer.

As to the second statutory purpose enunciated in Collins ---that of assuring that "selling literature and other offering material is used only when it has been preceded by a statutory prospectus so that people will not be influenced by such solicitation to buy before they see the prospectus"---on its face is not served by the reading below. By hypothesis, by the time a selling broker delivers his "comparison" to the purchasing broker, the ultimate purchaser has already made his independent decision to buy and has placed the purchase order with his own broker without any selling efforts or literature from the ultimate seller or his broker.

The rule adopted by Judge Werker will benefit only market-makers and other dealers, and then if, and only if, the selling shareholder sells through another broker. Had the plaintiffs simply called Faulkner directly, in response to its inser-

tion of bids in the Pink Sheets, and sold the stock to it without the intervention of another broker---Faulkner acting both as market-maker purchasing for its own account and also as plaintiffs' broker on the sale, compare, Chasins v. Smith, Barney & Co., 438 F.2d 1167 (2d Cir. 1970), there would have been no writing required of plaintiffs to which the language of section 2(10) could attach. Tobey & Kirk's sending of the "comparison" was not part of its limited agency for plaintiffs, but was done as a part of its own business as a broker. Thus the Court's reading of the statute advances no purpose of the Act, but merely penalizes plaintiffs for selling through their own broker, a result having no bearing on any policy of the Securities Act.

Judge Werker rejected the analogy and the conclusion to be drawn therefrom, id., at p. 99,347 (A-13):

> "Byrnes and Santangelo seek to avoid the effect of any adjudged failure of Tobey & Kirk by disassociating themselves from the acts of their broker. They argue that they personally never sent any written confirmations to the defendant and that as far as they are concerned, the prospectus delivery requirements did not become effective as to them until they actually deliver[e]d the securities themselves. They argue that they should not be charged with any failure by Tobey & Kirk to fulfill its obligations under the 1933 Act.
>
> "It is accurate to say that had Byrnes and Santangelo sold the securities without the assistance of a broker and had they themselves not sent any written confirmation to evidence the making of the contract, they would not have had to deliver a prospectus to Faulkner until they actually physically delivered the shares of White Shield. But that is not the way the transaction took place, and the plaintiffs will not be heard to argue that they could have avoided an unfavorable result by structuring their affairs differently."

However, far from trying to dissociate plaintiffs from their broker or urging that we could have arrived at a lawful result had we proceeded differently, as the Court below appears to suggest, we were attempting to stress the anomaly created by the reading given the statute by the Court below.

In sustaining the Second Affirmative Defense, Judge Werker erred. His holding exalts the naked language of the statute, as amended, ignoring the purpose and history of the original statute and the construction which Congress intended to enact into law. It ignores the Commission's own articulation of the policy which section 2(10), taken together with section 5, was designed to effectuate. It invents a rule which does not benefit members of the investing public for whose protection the Securities Act was adopted, while protecting only market-makers who have no need for such protection, and then only if the seller utilizes the services of another broker. To quote the Commission in Collins, supra, at pp. 85,802-03, it "ignores some 40 years of history, goes beyond the statutory purpose, does nothing to serve that purpose, and would create unnecessary complications in the trading markets."

The decision below, granting summary judgment to Faulkner and denying summary judgment to plaintiffs on the Second Affirmative Defense is wrong in principle and should be reversed, and on remand the District Court should be directed to enter summary judgment for plaintiffs on the Second Affirmative Defense.

POINT II

THE COURT BELOW ERRONEOUSLY DENIED SUMMARY JUDGMENT TO PLAINTIFFS ON THE THIRD AFFIRMATIVE DEFENSE, ALTHOUGH THE DEFENSE IS INSUFFICIENT AS A MATTER OF LAW AND FACT

Faulkner's Third Affirmative Defense charges that the prospectus itself violated the Securities Act by failing to identify Tobey & Kirk, by name, as an "underwriter." The prospectus in suit did state (A-141) that selling shareholders thereunder would offer the stock from time to time in the over-the-counter market through members of the NASD, would pay them "regular brokerage commissions" and added that "The selling shareholders and such participating members of the National Association of Securities Dealers, Inc. may be deemed to be underwriters as that term is defined in the Securities Act of 1933."

The omission from the prospectus of the names of the many brokers who might sell for the twenty-seven selling shareholders was pursuant to an informal agreement or undertaking between the issuer's counsel and the Commission's Staff. Under that undertaking, the selling shareholders were requested to supply the issuer's counsel with the identity of the broker through whom they sold their shares so that such information could be disclosed, if necessary, by post-effective sticker supplement to the prospectus (A-122-23, ## 4-6). On June 14, 1971 plaintiffs supplied counsel with the requested information (A-162-63), and on June 18, 1976, White Shield issued a sticker supplement (A-104, # 18; A-174), which stated that by selling for plaintiffs "Tobey & Kirk,

52 Wall Street, New York, New York may be deemed an 'underwriter' as that term is defined in the Securities Act of 1933."

The Third Affirmative Defense is insufficient for a number of reasons: (a) Tobey & Kirk was not an "underwriter" as a matter of law; (b) The "omission," if such it was, was not material; (c) Faulkner was not and could not have been misled; and (d) The procedure actually followed was pursuant to an informal agreement or undertaking between the issuer's counsel and the Staff of the Commission, so that section 19(a) of the Act shields plaintiffs from any putative violation of the Securities Act. This last ground for reversal is separately considered in Point III hereof.

(a) Tobey & Kirk was not an "underwriter" as a matter of law, so that the failure of the prospectus to identify it as such was not a violation of the Act

The Third Defense is insufficient because, as a matter of law, Tobey & Kirk was not an "underwriter," as that term is defined in section 2(11) of the Securities Act, 15 U.S.C. § 77b(11). Accordingly, the failure of the prospectus to describe Tobey & Kirk as an underwriter is not a violation of the statute.

Section 2(11), 15 U.S.C. § 77b(11), provides in pertinent part that:

> "The term 'underwriter' means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, . . . but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission.

> As used in this paragraph the term 'issuer' shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer."

The term "issuer" is also defined in section 2(4) of the Act to include "every person who issues or proposes to issue any security," and, in the case at Bar, White Shield Corporation.

These statutory provisions make clear that one is not an underwriter unless he purchases from, or offers or sells for, an issuer, however "issuer" be defined. There was neither any factual basis nor even any suggestion below that plaintiffs were "issuers". The evidence is uncontradicted that plaintiffs had purchased their White Shield stock in a private placement some three years before the public offering of the stock of White Shield (A-163-64, A-181-82), and at the time of that offering were not "directly or indirectly controlling or controlled by [White Shield,] the issuer, or . . . under direct or indirect common control with the issuer." They were not officers or directors of White Shield (A-139) and owned only 183,842 shares (A-139-40) out of a total of 4,735,216 shares outstanding as of March 31, 1971 (A-129), or 3.88%, which is scarcely "control." That figure includes stock owned by both plaintiffs and also 33,042 shares owned beneficially by two other individuals and of record by plaintiffs (A-139, nt. 2).

Thus, the very most that the plaintiffs themselves could be is "underwriters" because arguendo they had purchased from an "issuer" as defined. It necessarily follows that the

very most that can be said for Tobey & Kirk's role in the transaction is that it sold stock for an "underwriter." However, that does not make Tobey & Kirk an "underwriter," because the evidence is unequivocal (A-232-33) that Tobey & Kirk received from plaintiffs only the standard NASD broker's commission for selling plaintiffs' stock, and the antepenultimate clause of section 2(11) therefore excludes Tobey & Kirk from the definition of "underwriter" as a "person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission." As a matter of law Tobey & Kirk was not an "underwriter."

(b) Even if Tobey & Kirk were a statutory "underwriter" the failure to disclose that conclusion was not a material omission

Even if the Court were to disagree with our conclusion that Tobey & Kirk was not an underwriter, it does not follow that in failing to disclose, by name, that it was, the prospectus omitted a material fact which was necessary to make the other statements therein contained not misleading, in violation of section 11(a) or 12(2) of the Act, 15 U.S.C. §§ 77k(a), 77l(2).

There are two essential types of underwriter. The "contractual" underwriter, who has agreed to underwrite a public offering and assumes certain statutory responsibilities for the contents of the registration statement and prospectus. His status is a fact. There is also the "statutory underwriter," who falls within the broad language of section 2(11), but whose

status largely involves a conclusion of law. Tobey & Kirk could at most be a "statutory underwriter."

The identity of a contractual underwriter is a "material" fact which is required to be disclosed because, as this Court emphasized in Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F.2d 341, 370 (2d Cir. 1973); and Globus v. Law Research Service, Inc., 418 F.2d 1278, 1288-89 (2d Cir. 1969), the law---particularly sections 11(a)(5) and 12(2) of the Act, 15 U.S.C. §§ 77k(a)(5), 77l(2)---imposes significant duties and obligations upon contractual underwriters which in some respects compels them to assume a position adverse to that of an issuer before lending their imprimatur to the unexpertised portions of a registration statement and prospectus. The investing public is encouraged and entitled to rely upon the reputation and integrity of the underwriter and upon the implied representation that it has reviewed the prospectus and found it accurate and truthful. Escott v. BarChris Construction Corp., 283 F.Supp. 643, 696 (S.D.N.Y. 1968); Feit v. Leasco Data Processing Equipment Corp., 332 F.Supp. 544, 581 (E.D.N.Y. 1971).

Similarly, the amount of a contractual underwriter's discount or compensation may be material because it relates to how much the issuer will receive net from its offering after deduction of underwriting discounts or commissions, SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082 (2d Cir. 1972), and an overly large commission may itself reflect on the desirability as an investment of the securities being offered by the prospectus.

The prospectus in suit disclosed that sales would be made through NASD broker-dealers, who would receive the normal brokerage commission. The prospectus having disclosed that the brokers utilized by the selling shareholders would act in a largely ministerial capacity and be paid standard brokerage commission rates, it is hard to see how a prospective purchaser's investment decision would be affected if the prospectus had identified, in advance of the actual sales, each of the several dozen NASD broker-dealers whom the various selling shareholders intended to utilize, many of whom might not in fact end up selling the requisite amount of (or, indeed, any) securities.

Thus the failure of the prospectus in suit to articulate the legal conclusion that Tobey & Kirk might become an underwriter ---a legal conclusion which depends upon the happening of an event which may never occur---can scarcely constitute a violation of the statute or its policy to protect investors.

(c) The Court below erred in denying summary judgment to plaintiffs on the Third Affirmative Defense because of the existence of putative issues of fact concerning plaintiffs' own status as "underwriters" and the knowledge of Faulkner

The Court below viewed the Third Defense as presenting three questions requiring trial. Two of these were "(1) was Tobey & Kirk in fact an underwriter and (2) if it was, were the defendants aware of that fact, thus foreclosing their reliance on this section as a basis for avoiding the contract." The Court

also said that it "requires additional facts on the status of Tobey & Kirk." CCH Sec.L.Rep. ¶ 95,463, at p. 99,349 (A-15). We have already shown that there is really no issue of fact as to whether Tobey & Kirk was an "underwriter," and no further evidence on its status would alter that conclusion.

As to Faulkner's knowledge, we argued below that since Faulkner's traders had dealt solely with plaintiff Santangelo from the first contact until the price was agreed upon, and immediately after agreement with him on the price closed the trade with plaintiffs' broker, Faulkner could draw its own legal conclusion and infer that if plaintiffs were "issuers" Tobey & Kirk might be an "underwriter." To the extent that Tobey & Kirk's status involves a legal conclusion the "omission" to disclose that conclusion was not an omission of a material fact, as the Fifth Circuit said in Vohs v. Dickson, 495 F.2d 607, 625 (5th Cir. 1974):

> "The important point about the question in this case is that [it] . . . is not a matter of fact---material or otherwise; it is a matter of law. Rule 10b-5 cannot be construed to require a prospective seller of securities to give his prospective buyer legal advice on technical matters arising under the federal securities law. If the buyer is aware of the material facts . . . he should be as aware of the legal consequences of those facts as his seller. Here it is plain that plaintiffs knew as much as defendant about the facts relating to the legal need for taking with non-distributive intent."

Faulkner plainly had the sophistication. Cf., Gruss v. Curtis Publ. Co., ___ F.2d ___, CCH Sec.L.Rep. ¶ 95,524, at p. 99,688 (2d Cir. 1976).

Although there is grave doubt as to whether plaintiffs themselves can be characterized as "underwriters" since they had purchased their stock almost three years before for investment (A-163-64), cf., Vohs v. Dickson, supra, 495 F.2d at 620 (5th Cir. 1974), even if plaintiffs were underwriters, Tobey & Kirk was not, as a matter of law, because then it sold for an "underwriter" and received only the normal broker's commission.

Given all of these circumstances, the Third Defense is insufficient as a matter of law and the Court below erred in refusing to grant summary judgment to plaintiffs on that Defense.

POINT III

THE COURT BELOW IMPROPERLY DEPRIVED PLAINTIFFS OF THE RIGHT TO INVOKE THE EXCULPATORY PROVISIONS OF SECTION 19(a) OF THE SECURITIES ACT BECAUSE THEY WERE SUING RATHER THAN BEING SUED AND BECAUSE OF PUTATIVE ISSUES OF FACT

In granting summary judgment to Faulkner on the Second Affirmative Defense and in denying summary judgment to plaintiffs on the Second and Third Affirmative Defenses, the Court below rejected plaintiffs' contention that they are entitled to invoke the protections contained in section 19(a) of the Securities Act, 15 U.S.C. § 77s(a), which provides:

> "No provision of this subchapter imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason."

It appears that the principal rationale of the Court below in denying plaintiffs the right to invoke section 19(a) is that they are suing rather than being sued. In addition, with respect to the Third Defense, the Court believed that there were triable issues of fact relating largely to what disclosures had or should have been made by plaintiffs to the Commission, and whether plaintiffs "relied" on the rule or regulation they invoke.

Obviously, this Point, and plaintiffs' invocation of section 19(a), is relevant only if this Court holds that the Court below otherwise correctly granted summary judgment to Faulkner on the Second Defense and denied summary judgment to plaintiffs on the Second and Third Defenses.

(a) The Court's refusal to permit plaintiffs to invoke § 19(a) because they are suing rather than being sued is inconsistent with the policy of the Act

Judge Werker's denial of the protections of section 19(a) with respect to the Second Defense seems to be based upon his assumption that no "liability" under the Act was being imposed, the contract being unenforcible as a matter of public policy if its performance violated the Securities Act, CCH Sec.L.Rep. ¶ 95,463, at p. 99,347 (A-13):

> "The Second Affirmative Defense does not seek to impose liability on Byrnes and Santangelo. Rather, it is asserted as a defense against an action for damages for breach of contract. It was established in the case of Kaiser-Frazer Corp. v. Otis & Co., 195 F.2d 838 (2d Cir.), cert.denied, 344 U.S.856 (1952), that a contract which violates the 1933 Act is unenforceable. In that case the court found that a prospectus issued by the plaintiff was misleading and therefore violated 15

U.S.C. § 77e(b) if used in connection with a public offering. As a result, the court found the defendant not liable for breach of its contract with the plaintiff to underwrite the issue. '[A] contract which violates the laws of the United States and contravenes the public policy as expressed in those laws is unenforceable.' Id., at 843. Cf. Garfield v. Strain, 320 F.2d 116, 119 (10th Cir. 1963). See also Schillner v. H. Vaughan Clarke & Co., 134 F.2d 875 (2d Cir. 1943) in which the court held that '[i]n imposing by section 12(1) civil liability upon 'any person who * * * sells a security in violation of section 5' we cannot doubt that the liability was intended to embrace all transactions made unlawful by section 5.' Id. at 878. See also III L. Loss Securities Regulation 1797-98 (1961). It is true that the remedies authorized by § 12 include only 'recover[y of] the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or * * * damages if he no longer owns the security.' However, as Professor Loss points out, '[t]here would be little point in giving the seller an action on his contract only to have the buyer put things in statu quo ante by counterclaiming or bringing his own action under * * * § 12.' III Loss, supra at 1798."

On similar grounds the Court below rejected the applicability of section 19(a) to the Third Defense, id., at pp. 99,349-50 (A-15-16):

"Before leaving this matter, however, the court feels compelled to answer one further contention advanced by the plaintiffs: that § 19(a) of the 1933 Act or § 23(a) of the 1934 Act immunizes the plaintiffs from any violation of § 12(1) or (2) because they relied on the Commission's authorization in phrasing the statement on underwriters attacked by the defendant.

". . . Second, it should be noted that by its own terms, the section relied on only immunizes the plaintiffs from liability imposed by either of the two Acts; it does not protect them from any defense asserted in a breach of contract action. Thus, even assuming that all of the facts were in fact disclosed by the plaintiffs to the SEC, these sections are not applicable to the current dispute. It would be a wholly different matter if having requested and received SEC direction on a particular matter, the plaintiffs were then to be found liable in damages under one of the Acts for having followed those very directions. This court finds that the protection provided in § 19(a) of the 1933 Act and § 23(a) of the 1934 Act is unavailable in this instance."

The Court's disposition of plaintiffs' claim to the protections of section 19(a) is wrong in principle, misconceives the nature of the remedies created by the Act, and is not supported by the decisions cited by the Court below.

If one of the rationales for not requiring Faulkner to institute a plenary action or counterclaim under section 12 is that "there would be little point in giving the seller an action on his contract only to have the buyer put things in statu quo ante by counterclaiming or bringing his own action under . . . § 12," then, in order to achieve the status quo ante, it must necessarily follow that the results in each case should be the same. Manifestly that would not be the case here if plaintiffs would have been entitled to invoke section 19(a) in a suit by Faulkner, but are disabled to do so because, instead of paying and then suing to rescind, Faulkner rejected the trade and forced plaintiffs to sue.

Nor can the Court's rationale be sustained on the basis that section 19(a) applies only to "liabilities" under the Act and the plaintiffs are not being sued. Judge Werker's implicit rationale is that in asserting that the transaction violated one or more provisions of the Act, Faulkner is entitled to avoid the contract on some general principle of public policy. The Supreme Court has explicitly rejected any such approach, holding that if the contract is to be avoided, it must be done under the express provisions of the Act.

In A. C. Frost & Co. v. Coeur D'Alene Mines Corp., 312 U.S. 38, 41-43 (1941), the Supreme Court reversed a judgment declaring void a contract for the sale of securities on public policy grounds, saying:

> "No provision of the [Securities] Act declares that in the absence of registration contracts in contemplation of or having relation to a public offering shall be void. If there has been no registration, it penalizes the doing of certain designated things---use of the mails, instrumentalities of interstate commerce, etc. It also declares that those who participate in the proscribed action shall become liable to purchasers of the securities 'who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.' These are the sanctions which Congress has definitely provided in order to insure obedience to the statute. When invoked they must be given effect.
>
> "Although the challenged contract bears no evidence of criminality and is fair upon its face, we are asked to apply a sanction beyond that specified by declaring it null and void because of relationship to a public offering. The basis for this demand is a supposed federal public policy which requires such annulment in order to secure observance, effectuate the legislative purpose and prevent noxious consequences.
>
> "Courts have often added a sanction to those prescribed for an offense created by statute where the circumstances fairly indicated this would further the essential purpose of the enactment; but we think where the contrary definitely appears---actual hindrance indeed of that purpose---no such addition is permissible. The latter situation is beyond the reason which supports the doctrine now relied upon.
>
> "Here the clear legislative purpose was protection of innocent purchasers of securities. They are given definite remedies inconsistent with the idea that every contract having relation to sales of unregistered shares is absolutely void; and to accept the conclusion reached by the Supreme Court [of Idaho] below would probably seriously hinder rather than aid the real purpose of the statute." (Emphasis added).

Indeed, in Frost v. Coeur D'Alene, the SEC had filed an amicus brief in which it recognized that sections 11 and 12 of the Act, "by implication permit a purchaser to affirm a sale in violation of the Act." 312 U.S. at 43, nt. 2. Obviously, in the case at Bar neither Faulkner nor Singer & Mackie has elected to affirm, but whether they are entitled to disaffirm depends upon whether they could succeed in a suit against plaintiffs under sections 11, 12 or 14 of the Securities Act (or section 29(b) of the Exchange Act) to compel rescission of the contract of sale. Plaintiffs respectfully submit that a statutorily created duty to submit to an enforced rescission of a beneficial contract is no different in principle than being held liable in damages in the amount of the disgorged profit, and patently is a "liability" created by the Act, irrespective of who is suing whom.

Moreover, in any such a suit, where the right to avoid is given to the innocent party, recovery might be denied because the plaintiff is not an "unwilling innocent party." E.g., Naftalin v. Merrill Lynch, 469 F.2d 1166, 1132 (8th Cir. 1972); Kuehnert v. Texstar Corp., 412 F.2d 700 (5th Cir. 1969); James v. DuBrieul, 500 F.2d 155 (5th Cir. 1974). This is not at all the same as refusing, on public policy grounds, to lend the court's assistance to either party to an illegal contract.

Moreover, the authorities cited by the Court below do not sustain its holding that a contract is unenforcible on public policy grounds. Thus, in Kaiser-Frazer Corp. v. Otis & Co., supra, 195 F.2d 838 (2d Cir. 1952), which the Court below quoted

for the naked proposition that "it is clear that a contract which violates the laws of the United States and contravenes the public policy as expressed in those laws is unenforceable," CCH Sec.L.Rep. at p. 99,347 (A-13), the footnote attached to the quoted language from Kaiser-Frazer (nt. 8, 195 F.2d at 843-44) explains that the quoted conclusion flows from the language of the Securities Act itself:

> "8. Further support for our holding may be found in § 14 of the Act of 1933, 15 U.S.C.A. § 77n, . . .
>
> "The broad language of this section may be construed to brush aside ordinary contract principles of estoppel and waiver that might otherwise apply to contracts for securities, including underwriting agreements." (Quotation omitted).

Moreover, in Kaiser-Frazer, this Court made clear, 195 F.2d at 844, that the deficiencies of that prospectus were such that it could not lawfully be used in connection with the contemplated public offering, which necessarily rendered the underwriting contract itself unenforcible. In contrast, the Second Defense raises only a defense personal to Faulkner---one who has not received a prospectus with the "confirmation" may be entitled to rescind---he is not required to do so. And Faulkner's resale of the securities purchased from plaintiffs, although the purchase was confirmed to them without a prospectus, would give no subsequent purchaser from either of them the remedies of section 12.

Even further from the mark is the reliance of the Court below upon Garfield v. Strain, 320 F.2d 116, 119 (10th Cir. 1963), because there the Tenth Circuit said:

> "It seems to be assumed that if the sale was in violation of the Securities Act, . . . the purchaser is entitled to rescind the contract and no action would lie upon it. Cf. A. C. Frost & Co. v. Coeur D'Alene Mines Corp., 312 U.S. 38, 61 S.Ct. 414. For purposes of this appeal, we will indulge in the same assumption."

Having "indulge[d] the assumption" the Tenth Circuit held that there had been no violation of the Act and affirmed the decision below. This scarcely is authority for the proposition for which Garfield v. Strain was cited by the Court below. Moreover, in the light of its citation of Frost v. Coeur D'Alene, supra, it can scarcely be supposed that the Tenth Circuit intended to make the holding which the Court below ascribed to it.

Similarly there is scant support, if any, for the conclusion reached below based upon this Court's decision in Schillner v. H. Vaughan Clarke & Co., supra, 134 F.2d 875 (2d Cir. 1943). There this Court affirmed a judgment rendered under section 12(2) of the Securities Act, in a suit brought by the purchaser against her seller---precisely the situation envisaged by section 12(2). The passage quoted by Judge Werker below recognizes that the liability imposed by section 12(1) or 12(2) "embrace[s] all transactions made unlawful by section 5," which scarcely does more than to say what section 12 itself says. But the "liability" to which this Court referred is the explicit liability created by section 12, and not some generalized public policy rationale for avoiding contracts, inconsistent with the express liabilities and dependent solely upon who is suing whom.

Finally, the Court's discussion of the Third Defense itself demonstrates the manifest incorrectness of its holding

that the protections of section 19(a) are not available to one who is suing rather than being sued. Judge Werker devotes almost five printed columns (pp. 99,347-50, A-13-16) to his discussion of the Third Defense. Of these, not less than three columns (pp. 99,348-49, A-14-15) are devoted to an analysis of which section, as between 12(1) and 12(2), is the correct remedial statute to be applied to the putative violation resulting from the "omission" of the prospectus to name Tobey & Kirk as "underwriter". Judge Werker correctly, in our judgment, reasons that the proper section must be section 12(2). But the Court's discussion itself demonstrates that a consideration of the Third Defense itself necessarily requires an examination of what would be the result in a suit by Faulkner, and illustrates the conceptual flaw in the Court's holding that although section 19(a) might furnish a defense to such a suit, it is not applicable here because the suit is brought by plaintiffs and not against them. Plaintiffs submit that the distinction is meaningless and indefensible, and the District Court's rejection of resort to section 19(a) should be reversed.

(b) The failure to deliver a prospectus with the "comparison", and to identify Tobey & Kirk as an "underwriter" "conformed" to SEC rules and regulations within the meaning of § 19(a)

Granting that plaintiffs were entitled to invoke the exculpatory provisions of section 19(a), the question would then be whether the General Counsel's Opinion (and particularly Ques-

tion and Answer # 8), applicable to the Second Defense, and the Commission's Staff's informal agreement to or acquiescence in the issuer's counsel's undertaking to supplement the prospectus with the names and addresses of statutory underwriters qualify as "rules or regulations" to which section 19(a) attaches.

The answer is relatively easy in the case of the General Counsel's Opinion since it is now clearly established by this Court's decision in Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1284 (2d Cir. 1973), that the protections of section 19(a) of the Securities Act (or of the virtually identical section 23(a) of the Exchange Act, 15 U.S.C. § 78w(a)), are available notwithstanding that the "rule" or "regulation" has not been formally adopted.

Moreover, the protections of section 19(a) are based upon "good faith conformity" not "good faith reliance", so that the right to invoke the section does not require the party claiming it himself to make inquiries of the Commission (as the rationale of the Court below with respect to the Third Defense (A-15) seems to suggest). The protections of the section come into force if there is a justifiable established practice and a common understanding among the Bar specializing in the securities field. As this Court said in Gerstle, supra, 478 F.2d at 1294, it applies if the conduct is based upon "a general understanding . . . regularly given effect by the Commission's able staff in dealing with lawyers who specialize in SEC matters," or consists of an understanding which has become "an article of faith among lawyers

specializing in the securities field," id., at 1293, or one which is based upon "the Commission's consistent interpretation of its own rule," id., at 1294. There is no duty to make individual inquiries by the party invoking its protections.

Similarly, in SEC v. Harwyn Industries Corp., 326 F.Supp. 943, 954 (S.D.N.Y. 1971), Judge Mansfield in effect applied section 19(a), although it had not been invoked in terms, in denying injunctive relief to the Commission because of "defendants' good faith reliance upon their counsel's interpretation of § 5," an interpretation which was itself based upon

> "a view that had evolved through the years as a result of the Commission's issuance in 1936 of Release No. 33-929 and its failure thereafter to dispel the interpretation generally put upon the Release by the bar. Feeding upon itself the view became a loophole. . .;" ibid.

As respects the Second Defense, Tobey & Kirk's conduct was "in conformity with" a Commission Release, as in Harwyn.

Moreover, as respects the availability of section 19(a) to the Third Defense, it must be noted that the prospectus itself was issued by White Shield, whose special SEC counsel had obtained the Commission's Staff's implicit agreement or acquiescence in the practice followed. In Harwyn, Judge Mansfield found it significant that defendants had acted on advice of counsel, id., at 955:

> "The first of the facts which we deem relevant is that defendants at all times relied on the advice of counsel. . . . This advice, that the transactions were legal and no registration was required, was rendered in the light of prevailing business practices, the ambiguity which surrounded the applicability of the 1933 Act to stock dividends, and the acquiescence in spin-offs of unregistered stock by the Commission."

Here there was little ambiguity as to the practice of not listing by name each potential statutory underwriter, because that is a practice commonly used in "shelf registrations"---i.e., distributions which are not underwritten.

As respects the Second Defense, applying section 19(a) to the new-found obligation of delivering a prospectus with a comparison is easier than in Harwyn. In both cases, the "article of faith" was based upon an SEC Release (here the General Counsel's Opinion). However, unlike Harwyn, where the earlier Release had been greatly undercut by more recent releases and by published warnings that the Commission viewed the challenged practice with concern, here the substance of the earlier release had been enacted into law, and it was not until the filing of the Commission's amicus memorandum in May 1975, almost exactly five years after the transaction giving rise to the present action, that the Commission first voiced the possibility that sections 2(10) and 5(b)(1) might apply to a broker's "comparison." In these circumstances, it seems to us that section 19(a) should be applicable to both Affirmative Defenses.

(c) The Court improperly denied summary judgment as to the Third Defense on the basis of suppositions of facts not of record and contrary to the common registration practice

In addition to the reason for denying resort to section 19(a) which was common to both the Second and Third Defense, Judge Werker improperly indulged Faulkner's speculations as to a

pseudo-fact issue as to whether plaintiffs might have withheld information from the Commission, or even misrepresented facts to it, thus leading the Staff to agree to a procedure which, had it known the true facts, it would have rejected. Thus the Court below said, CCH Sec.L.Rep. ¶ 95,463, at pp. 99,349-50 (A-15-16):

> "First, the defendant raises a significant factual question as to whether all of the facts relevant to Tobey & Kirk's status were in fact disclosed to the SEC. Unless that issue is resolved in plaintiffs' favor, they cannot rely on any authorization provided by the SEC."

The assumption that plaintiffs might have withheld facts from the Commission is premised upon Faulkner's contention, id., at p. 99,348 (A-14):

> "that it was clear several months prior to the publication of the prospectus that Tobey & Kirk were, in fact, underwriters of the proposed distribution and that had the SEC been apprised of that fact, it would have required disclosure of that fact."

The contention is specious. In the first place, Point II demonstrates that Tobey & Kirk's putative status as an "underwriter" is anything but clear. Secondly, Faulkner's contention simply ignores the realities of the registration process under the Securities Act in which selling shareholders are not required or expected to communicate directly with the Commission's Staff. Registration statements are invariably prepared and filed by the issuer, and all communications with the Securities and Exchange Commission in connection with the contents of registration statements are from the issuer, generally through its SEC counsel, to whom the Staff's "Letter(s) of Comments" are in turn addressed.

This being the general practice, and there being no direct evidence that either of the plaintiffs (or Tobey & Kirk) had had any communication with the Commission or its Staff, and in the light of the fact that the contention was raised in opposition to a motion for summary judgment, if Faulkner had any contrary evidence, FRCP 56(e) and 56(f) required it either to come forward with the evidence or to explain its absence, cf., Radio City Music Hall Corp. v. United States, 135 F.2d 715, 718 (2d Cir. 1943; L. Hand, J.); Engl v. Aetna Life Ins. Co., 139 F.2d 467, 473 (2d Cir. 1943), and the Court below erred in entertaining what amounts to little more than a speculative suggestion by Faulkner.

Moreover, there was affirmative evidence in the record, given by a non-party whom Faulkner could readily have deposed---George J. Solomon, Esq., the issuer's SEC counsel---that the common practice of channelling all communications with the SEC through the issuer's counsel was actually followed here. In addition, the Commission, as amicus below, was singularly well-situated to bring such putative facts---if they existed---to the Court's attention. But, although the Commission urged that judgment be entered against plaintiffs on four separate grounds, it took no position as to the Third Defense or the plaintiffs' invocation of section 19(a), which suggests that Faulkner's contention is wholly lacking in factual basis and should not have been entertained below.

The Solomon affidavit completely rebuts Faulkner's insinuations and the Court's assumption that those insinuations

raise a factual issue warranting denial of summary judgment. Thus, paragraph 2(c) (A-121) discloses that the registration statement covering the shares of the plaintiffs and twenty-five other selling shareholders was first filed on May 13, 1971. Paragraph 4 discloses (A-122) that in a letter of comments dated May 27, 1971---only two weeks after the filing of the registration statement---the Commission's Staff requested the issuer to furnish the identity of NASD members who transact dealings in more than 10% of the shares being registered" by two of the four White Shield registration statements, including the one registering plaintiffs' shares. Paragraph 5 then discloses (A-122) that on June 3, 1971 the issuer through its counsel undertook to supply such information "from time to time as necessary after the effective date" of the registration statement(s), and the Staff evidently concurred in this undertaking because it declared the registration statement in suit effective on June 7, 1971---virtually upon the receipt of the "undertaking."

Paragraph 6 then discloses (A-123, 161) that on June 3, 1971 (a Thursday), counsel wrote to each of the selling shareholders under two registration statements to which the undertaking applied, advising them that they were obliged to inform the company promptly "of the identity of each broker-dealer firm utilized in the sale of shares and of the number of shares such broker-dealer was requested to sell." Assuming that counsel's letter was received by plaintiffs as early as Friday, June 4, 1971, it strains credulity to believe either that plaintiffs had

any communication with the Commission prior to noon, Monday, June 7, 1971, when their registration statement was declared effective, or that they were obliged to furnish counsel with the information (as yet only conjectural) before the registration statement became effective on the next business day.

Rather, as paragraph 7 of the Solomon affidavit discloses (and Exhibit "7" thereto confirms, A-123, 169-70), on June 14, 1971, after plaintiffs thought that they had sold out their stock, they informed counsel of the total number of shares sold, through whom and to whom they were sold, and the number of shares sold to each purchaser, precisely what had been requested by the issuer's counsel "in good faith conformity" with the undertaking given to and accepted by the Commission's Staff.

Thus, plaintiffs, acting through the issuer's counsel, gave to the SEC the precise information which it had requested of the issuer's counsel, and they did so in precisely the manner in which the Commission's Staff had agreed to receive it. There is no factual showing either that they made any independent disclosures to the Commission or that they were asked to do anything other than what they actually did.

The decision below threatens every selling shareholder with a full-blown trial on the question of whether he had had communications with the Commission, or whether he should have had them, and would result in vastly complicating the registration process. In order to be safe, selling shareholders would tend to second-guess the issuer's counsel, and to communicate directly

with the already overworked Commission Staff. No legitimate statutory purpose would be served by such a procedure. The "question of fact" here is spurious.

Section 19(a) required that summary judgment be granted to plaintiffs on the Second and Third Affirmative Defenses.

POINT IV

THE COURT BELOW ERRED IN REFUSING SUMMARY JUDGMENT TO PLAINTIFFS DISMISSING THE FIRST DEFENSE BECAUSE THE TESTIMONY OF FAULKNER'S OWN TRADERS ESTABLISHES THAT THE RULE 10b-5 DEFENSE INVOLVES ONLY A QUESTION OF LAW, NOT ONE OF FACT

Faulkner's First Affirmative Defense alleges that plaintiffs violated Rule 10b-5 by allegedly failing to disclose the fact that the shares being offered to Faulkner were part of a registered "secondary distribution." However, the dispute is not as to what was said but as to what was required to be said, since Faulkner's own traders admit that plaintiff Santangelo told them that he was selling some distribution stock when he told them "if you'll look in the prospectus you'll see that I was one of the selling shareholders" (A-268-69). They also admit that he repeatedly refused to sell them the stock because he was awaiting "SEC clearance" (A-333-34, 357).

The traders apparently misunderstood what they were being told because they only knew of one secondary distribution---the so-called "Leason secondary"---and when they asked Santangelo if his stock was part of that secondary, he truthfully told them

it was not. From his answer they incorrectly inferred that the stock was not part of any secondary distribution. Nor did either of the Faulkner traders inquire into the nature of the "SEC clearance" which Santangelo was awaiting.

Thus the Rule 10b-5 contention comes down to a question not of what was said, but of the scope of the duty to disclose. Plaintiffs contend that they did not violate Rule 10b-5 because they neither knew the Jaffee Rule nor had any reason to know it, so that the registered character of their stock was not a material fact to them. They did not suspect that Faulkner was ignorant of the four virtually simultaneous White Shield distributions and so might misunderstand Santangelo's truthful answers to the traders' direct inquiries about the Leason secondary. They contend that their duty was to answer the questions actually asked by the Faulkner traders, not to guess what the Faulkner traders were attempting to find out. Faulkner, supported by the Commission as amicus below, contends that this argument signals a return to caveat emptor. If so, it has received the sanction of a number of Courts of Appeals, including this Court.

Judge Werker apparently misunderstood the argument. Without discussing the mounting authority for a subjective test of materiality of peripheral matters, he denied summary judgment because "the facts are in sharp dispute as to both the fact of omission and extent of Faulkner's inquiry as to the status of the stock," CCH Sec.L.Rep. ¶ 95,463, p. 99,343 (A-9), and assumed "materiality", p. 99,342 (A-8):

> "The parties seem to agree, as does the court, that failure to disclose the fact that the stock being sold was, in fact registered stock would be a material and fraudulent omission in violation of . . . Section 10(b) of the 1934 Act. Cf. Vohs v. Dickson, 495 F.2d 607 (5th Cir. 1974). This is particularly true in light of In the Matters of Jaffee & Co. [1969-1970 Transfer Binder] CCH Fed.Sec.L.Rep. ¶ 77,805 (1970), . . . The issue is whether in fact there was such an omission."

On reargument we asked the District Court to correct this statement because far from reflecting the "agreement" of the parties, it was diametrically contrary to plaintiffs' position. We argued as follows:

> "Contrary to the quoted language of the Court, it has been plaintiffs' consistent position . . . that the scope of the duty of disclosure turns upon the relative knowledge of the seller and the purchaser. See, e.g., SEC v. Coffey, 493 F.2d 1304 (6th Cir. 1974); Frigitemp Corp. v. Financial Dynamics Fund, Inc., 524 F.2d 275, 282 (2d Cir. 1975); Thomas v. Duralite Co, Inc., 524 F.2d 577, 584 (3d Cir. 1975); Eason v. GMAC, 490 F.2d 654, 660 nt. 28 (7th Cir. 1973; J. P. Stevens, J.), . . ."

The District Court modified the quoted language, but still missed the thrust of plaintiffs' contention (A-23):

> "The parties seem to agree, as does the court, that failure to disclose the fact that the stock being sold was, in fact, registered is a material omission."

(a) Plaintiffs did not violate Rule 10b-5, as a matter of law, because Faulkner's self-imposed ignorance of publicly-available facts prevented it from understanding plaintiffs' truthful disclosures

Excluding such matters as are conventionally "material" to any informed investment decision, as to which the test may be

an objective one, the law is now clear that on peripheral matters the scope and extent of the disclosures required under the Exchange Act depend upon the context in which the disclosures are made, the identity and presumed knowledge of the parties, and the circumstances. As Judge (now Justice) Stevens said in Eason v. GMAC, 490 F.2d 654, 660 nt. 28 (7th Cir. 1973), the Exchange Act is

> "A flexible statute which emphasizes the relevance of the context in which a transaction takes place . . . [and should not] arbitrarily assume that every purchaser and every seller is entitled to precisely the same disclosure."

And, as noted in Vohs v. Dickson, supra, 495 F.2d 607, 623 (5th Cir. 1974), a purchaser too is "charged with a duty of reasonable investigation." That duty was totally ignored by Faulkner. Had it been observed, there would have been no problem, no ambiguity, and no lawsuit.

It is clear that if Faulkner had obtained a copy of the prospectus (A-130-37) covering the "Leason secondary"---of which its traders had knowledge for at least a month---it would have learned from that prospectus (and the Base Prospectus incorporated therein) of the existence of four distributions (A-129, nt. 5). Had it then obtained copies of all four prospectuses, the prospectus in suit would have disclosed not only that Santangelo was a selling shareholder in a secondary distribution, but that he did not own 44,000 shares apart from those being offered by the prospectus (A-139). Armed with this information, Faulkner's traders could have asked him some meaningful questions, and they would have received pertinent answers.

Santangelo admittedly disclosed to Faulkner's traders that his name appeared in a prospectus. Both traders admit they asked him whether the stock being offered to them was part of the "Leason secondary," and that he told them that it was not, concealing nothing and having no reason to assume that they knew of no other secondary. Santangelo did not know the Jaffee Rule and had no reason to know it (A-175-77, ##4-6), and he therefore did not know the significance of distribution stock to a market-maker. He did not even know Faulkner was making a market in stock of White Shield (A-183). The traders appeared to be curious only about the Leason secondary (for reasons they never explained). They never intimated that they would not purchase the stock if it were part of the Leason secondary, or, a fortiori, if it were part of any other secondary distribution. Santangelo did not violate Rule 10b-5 because he was unable to divine from their questions about the Leason secondary that what they really wanted to know was whether the stock was registered in any secondary, or that they would not buy any distribution stock.

Rule 10b-5 is not violated because the Faulkner traders erroneously concluded from Santangelo's truthful answers to their direct questions that his stock was not part of any secondary. Santangelo never made that representation nor intended to be understood as having said so. The misunderstanding or ambiguity resulted from Faulkner's studied refusal to inform itself as to publicly-available facts relating to a security in which it was making a market. Faulkner's self-imposed ignorance creates no

Rule 10b-5 liability in those with whom it dealt. The cases make clear that for there to be Rule 10b-5 liability for an omission of fact, the fact must be material and the party omitting it must have some reason to believe it material to the other party. Here plaintiffs had no such reason.

Thus, in Frigitemp Corp. v. Financial Dynamics Fund, 524 F.2d 275, 282 (2d Cir. 1975), this Court said:

> "As Judge Tenney noted, the purchases of Frigitemp shares by the Funds in substantial amounts were not concealed. The appellants discovered from a perusal of available transfer sheets much later what they could have discovered at the time---that the Funds had purchased a large number of shares. Since the appellees had a right to assume that the volume of their purchases was known to appellants, there was no reason for them to disclose the fact. . . .
>
> "Whether 'constructive knowledge,' or 'ready access to the information involved,' . . . is always a bar to the plaintiff we need not decide. Suffice it to say that even if we lower the requirement of scienter on the part of the defendant, see discussion in Lanza v. Drexel & Co., 479 F.2d 1277 (2 Cir. 1973)(en banc), his reasonable belief that the other party already has access to the facts should excuse him from new disclosures which reasonably appear to be repetitive." (Emphasis, other than "plaintiff" and "defendant", added; most citations omitted).

And see, Thomas v. Duralite Co., Inc., 524 F.2d 577, 584 (3d Cir. 1975); cf., Gruss v. Curtis Publishing Co., ___ F.2d ___, CCH Sec.L.Rep. ¶ 95,524, at pp. 99,687-88 (2d Cir. 1974).

In SEC v. Coffey, 493 F.2d 1304, 1313 (6th Cir. 1974), the Court said:

> "Fraud or deceit presupposes the superior knowledge of one party over another. . . . The State [the purchaser] was not in the position of an innocent purchaser, misled by an insider's use of a prime rating on short-

term paper to justify the quality of its longer term notes, since the State itself required precisely the showing it received. A . . . Rule 10b-5(1) and (3) violation depends upon one party's taking an unfair advantage of another party through a deceptive practice or fraudulent scheme. There is no duty to disclose information to one who reasonably should already be aware of it." (Emphasis added).

Elsewhere in Coffey, 493 F.2d at 1314, the Court explicitly required a showing that "Coffey knew or should have known that the omitted information was significant to NCO":

"As to Appellant Coffey, who personally sent financial information to NCO, a potential finding under Rule 10b-5(2) is that he omitted material facts necessary to make the statements made to NCO not misleading. If the SEC can prove that the alleged omissions represent facts which were known or should have been known by Coffey while dealing with NCO, that they were necessary to make the information forwarded to NCO not misleading, and that Coffey knew or should have known that the omitted information was significant to NCO within the principles of SEC v. Capital Gains Bureau, 375 U.S. 180 . . . (1963), then Coffey may have violated Rule 10b-5(2). . . ." (Emphasis added).

Again, in Kohler v. Kohler Co., 319 F.2d 634, 641-42 (7th Cir. 1963)---a suit brought by an allegedly defrauded seller ---Judge Swygert said:

"Furthermore, honesty and fairness permit consideration of the actual and normal business acumen of the seller. Here, the company could fairly deal with a person who had had many years of intimate acquaintance with the affairs of the corporation, who was closely related to many principals of the corporation, who had extrinsic sources of sound business advice, and who himself was promoting a speedy sale, in a manner that might not be fair if plaintiff had been a novice to stock transactions or the corporation's activities.

"On one hand, corporate insiders must scrupulously disclose to outsiders those material facts about a corporation's business which in reasonable and objective contemplation might affect the value of the corpora-

tion's stock or securities and which the insiders should reasonably believe are unknown to the outsider. On the other hand, they are not required to search out details that presumably would not influence the person's judgment with whom they are dealing." (Emphasis added).

Arber v. Essex Wire Corp., 490 F.2d 414, 420 (6th Cir. 1974), held that a party cannot claim to have been defrauded by the failure of another to disclose facts which were both freely available and known by the complaining party to be available, and thus remedy his own prior lack of interest:

> "Appellants also claim that appellees did not disclose book value which was substantially greater than the offer price, and other financial data such as earnings per share. This information, however, was readily available to appellants who, although aware of its existence and availability, were simply uninterested. We hold that an insider has no affirmative duty to direct a seller's attention to all routine data commonly found in the statements and books of the corporation, at least where that information is readily available, the outsider has knowledge that it is available and makes no inquiry; and the information thus available is not of an unusual or extraordinary nature." (Emphasis added).

Given the history of daily entreaties by the Faulkner traders to Santangelo to sell, and his repeated refusals, the Fifth Circuit's terse comment in Vohs v. Dickson, 495 F.2d 607, 624 (5th Cir. 1974), is also significant:

> "The record presents a picture of aggressive purchasers who took it upon themselves to ascertain the status of the company and its stock, not persons who passively relied on the knowledge and advice of their seller."

Here Faulkner, a market-maker in White Shield stock, knew of the existence of at least one secondary in that stock. It therefore knew or should have known that a prospectus was available, and it concededly knew that the prospectus would disclose the identity

of selling shareholders (A-436-37). It says that it did not bother to procure a copy. Had it done so it would have known everything which it now contends Santangelo was duty-bound to disclose. Faulkner has no standing to complain that in the course of telephone conversations with its traders, carried on in the jargon of Wall Street, Santangelo failed to disclose what Faulkner claims to have been interested in ascertaining but never asked. It is clear that Faulkner knew the pertinent fact of registration well in advance of the sale in suit. It knew how to obtain the details. It was, as the Sixth Circuit put it in Arber, "simply uninterested".

Moreover there is significant evidence in Jaffee itself---upon which Faulkner's house counsel purported to rely in rejecting the transaction---that a market-maker is required to keep himself abreast of distributions in securities in which he is making a market, and to obtain prospectuses of known distributions in such securities. In Jaffee, Greene & Co.---the "market-maker"---was held to have violated Rule 10b-6 because, knowing of the existence of the distribution, it nevertheless continued to purchase securities from Lee & Co.---the "exclusive agent" (i.e., "underwriter") for all of the selling shareholders---without inquiring into the status of the offering. Matter of Jaffee & Co., CCH Sec.L.Rep. ¶ 77,805 at p. 83,858 (1970). Thus, while purporting to have regarded the fact of registration material because of Jaffee, Faulkner kept itself ignorant despite Jaffee.

To summarize, plaintiffs' duty of disclosure must be measured by the relative states of the knowledge of the two

parties, and by plaintiffs' reasonable belief that the information relating to their participation in the White Shield distribution was already known to the Faulkner traders. No Rule 10b-5 liability results from any misunderstanding of the actual disclosures itself resulting from Faulkner's self-imposed blindness to publicly-available information, knowledge of which would have put the actual verbal disclosures into an unambiguous context.

On these facts, there has been no violation of Rule 10b-5 by the plaintiffs, as a matter of law. This is not a return to caveat emptor. It is a refusal to convert a rule requiring full disclosure into one compelling a seller of securities, at his peril, to divine the purchaser's undisclosed concerns.

(b) The undisputed facts are that plaintiffs did disclose that their stock was in registration and could not be sold without "SEC clearance"

It is undisputed that plaintiff Santangelo first telephoned Faulkner on or about June 1, 1971 (after learning that Faulkner had been a big buyer of White Shield stock) and inquired as to its interest in buying a block of White Shield stock (A-359). On that day MacMillen returned Santangelo's call and told him he would be interested in buying the 44,000 shares available. The sale was not made until after the registration statement was declared effective on June 7, 1971, notwithstanding that MacMillen (or Lattuga) spoke to and attempted unsuccessfully to buy the stock from Santangelo on each and every business day including

June 7, 1971---i.e., on June 1, 2, 3, 4 and 7, 1971---but was refused on each occasion because "SEC clearance" had not yet been received.

On their respective depositions, Santangelo and Ross were asked whether in any of these conversations they had in so many words told MacMillen or Lattuga that the stock they were offering was "in registration." Both replied in the affirmative (Ross having testified that he was present while Santangelo spoke to MacMillen on most of those days). Santangelo testified (A-185-86) that he had used the term "registration" (A-188):

> "Q Do you recall whether Mr. MacMillen at any time asked you during any of these telephone conversations whether the stock was included in a registration statement?
>
> "A Yes, because he couldn't understand why I couldn't sell him the stock, and I kept telling him 'I can't sell it to you until it's effective, until I am out of registration.'"

Ross testified that he had told MacMillen that "we could not sell him the stock because it was still in registration" (A-240), and that he even offered MacMillen a "red herring" prospectus which MacMillen allegedly declined because Faulkner already had a copy (A-241). Ross testified that the stock was finally sold to Faulkner on June 7, 1971, after earlier refusals, only after Santangelo had told MacMillen, in Ross's presence, that he "had received word from the attorneys for White Shield that the stock was out of registration and could be traded" (A-243), which testimony is confirmed by plaintiff Byrnes's affidavit (A-165, # 5).

The Faulkner traders do not admit that the word "registration" was used. If the issue before the District Court were whether those actual words had been used, we would agree that summary judgment could not be granted to either party. But that was never the issue before the Court below. Full disclosure does not depend upon the form of the words utilized, or whether, "in the bright gleam of hindsight," Friendly, J., concurring in SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 867 (2d Cir. 1968), a better statement becomes apparent. And see, Gruss v. Curtis Publishing Co., ___ F.2d ___, CCH Sec.L. Rep. ¶ 95,524, at pp. 99,687-88 (2d Cir. 1976). As the Commission itself said in its amicus memorandum below (p. 32, nt. 38), "the inquiry should be, simply, whether the purchaser knew of the fact of registration at the time he agreed to purchase the shares." The testimony of Faulkner's traders establishes that the purchaser here did know.

MacMillen's Testimony

That the fact of registration was disclosed is conclusively established through the testimony of Faulkner's trader, MacMillen, who had most of the pertinent conversations with plaintiff. He admitted that Santangelo had told him that he was selling stock pursuant to a registration statement, and actually told him to look in the prospectus where he would find Santangelo's name as a selling shareholder (A-268, 338-39). MacMillen's admission should end the inquiry.

The issue survives only because there was some confusion in MacMillen's earlier testimony. Although he conceded from the

beginning that Santangelo had told him "if you'll look in the prospectus, you'll see that I was one of the selling stockholders" (A-268-69), at first he ascribed to Santangelo a reference to the "Leason secondary," and an assurance by Santangelo that the stock being offered to Faulkner was "away from that secondary." The early part of MacMillen's testimony (upon which Faulkner's claim of affirmative misrepresentation is based) is as follows (A-268-69):

> "When we originally spoke to him about the trade he said, if you'll look in the prospectus, you'll see that I was one of the selling stockholders in the secondary that was offered by Leason & Co., so forth.
>
> "He says, this is away from that secondary. He said this is stock in another group I belong to, another corporation I belong to." (Emphasis added).

However, later in his deposition MacMillen testified that the underscored words "in the secondary that was offered by Leason & Co., so forth" were MacMillen's own, and not Santangelo's, and that Santangelo had never told him that he had any stock in the Leason secondary. He testified that in respose to Santangelo's statement that his name appeared in a prospectus, MacMillen himself asked Santangelo whether the stock was part of the Leason secondary, and admits Santangelo responded that the stock was not part of the Leason secondary (A-340-41):

> "A He said, 'if you'll look in the prospectus, you'll see my name.' This is the statement I believe I made to you where you might have --
>
> * * *

"Q 'If you look in the prospectus,' he said, 'you will see my name.' Did he say, 'if you'll look in the Leason prospectus?'

"A My assumption would be that he was making reference to the Leason prospectus, yes.

"Q It would be your assumption?

"A Right.

"Q And it would be your assumption whether or not he actually said, 'if you look in the Leason prospectus,' isn't that correct, because you only knew of one prospectus on June the 4th, June the 3rd and June the 2nd?

"A That's correct." (Internal quotes added).

This inquiry was pursued on cross-examination (A-347-48):

"Q [By Mr. Bayda] You testified that in one of these telephone conversations prior to the trade with Mr. Santangelo, Mr. Santangelo referred to a prospectus with his name in it. Did he tell you in this particular conversation that the stock being sold to Faulkner was outside of that, that it had nothing to do with that?

"A Yes, he did.

"MR. BAYDA: I have no further questions.

EXAMINATION BY MR. DUFF:

"Q You're quite sure of that?

"A Well, let me answer your question in another way. I put the question to him.

"Q What question did you put to him?

"A Whether or not this was part of the Leason secondary. Or if the stock that he was selling was away from that Leason or a part of--apart from the Leason secondary. He said, 'yes'.

"Q And that was what you [meant when you] answered Mr. Bayda's question?

"A Yes." (Internal quote added).

Thus, MacMillen's testimony, taken as a whole, is that (a) Santangelo told him that his name appeared as a selling stockholder in a prospectus; (b) MacMillen asked him if the stock was part of the Leason secondary; (c) Santangelo told him that the stock was "apart from" the Leason secondary; (d) MacMillen concluded that the stock was therefore unregistered but Santangelo never said so himself. Indeed, MacMillen explicitly admitted as much (A-328):

> "Q My question is, did he [Santangelo] ever tell you that they [the shares being offered] were not part of any other registered offering?
>
> "A Never did.
>
> "Q Did he ever imply to you that they were not part of any other registered offering?
>
> "A To the best of my recollection, no."

Santangelo's response was neither calculated to deceive nor deceptive in itself. Santangelo himself had no reason to believe that MacMillen did not know of three imminent secondary distributions other than the Leason secondary, nor did he know the importance which Faulkner allegedly attached to not purchasing distribution stock. MacMillen appeared to be curious only about the Leason secondary (for reasons which he did not explain), and Santangelo told him in good faith that his stock was not part of that secondary.

It is also significant that these several admitted conversations between MacMillen and Santangelo occurred at a time when Santangelo was repeatedly declining to sell the stock because

he was awaiting "SEC clearance". It would have been curious indeed if MacMillen, eager as he evidently was to purchase the stock, had failed to ask why Santangelo would not or could not sell. Both Santangelo and Ross have testified (ante, p. 72) that MacMillen made that precise inquiry, and that he was told the stock could not be sold until it was out of registration.

MacMillen himself admitted that Santangelo had told him that he could not sell the stock because he was awaiting "SEC clearance," and he conceded (A-333-34) that he understood the reference to "SEC clearance" to mean that the stock being offered to Faulkner might be in registration, but did not inquire. MacMillen's precise testimony is as follows:

> "Q Now, we have also had testimony that, and I'm not sure how far we have gone with this, but we have had testimony that Mr. Santangelo told you at a certain time, or I guess at several times, that he was waiting for, I think it's fair to use your words, SEC clearance.
>
> "A That's correct.
>
> "Q As to the shares which he was offering to you. What do those words SEC clearance mean to you?
>
> "A Well, that he had stock in registration with the SEC waiting for a formal letter of the stock to be sold in the street, that's what it meant to me. Or waiting for word from Washington that the stock could be sold.
>
> "Q So when he talks to you of SEC clearance, the several times he used that phrase to you, or some comparable phrase, that meant that his shares were in registration and he was waiting for the SEC to clear that registration and allow those shares to be sold?
>
> "A That's correct.

"Q Well, if I understand you, then, it would seem to me that the first time that Santangelo used the words to you, SEC clearance, and told you he was waiting for that, then at that point you realized that the shares he was selling to you were in some form of registration with the SEC, is that right?

"A That's correct.

"Q Now, when you realized that the shares you were buying were in registration with the SEC, did it occur to you that you should ask for a prospectus for those shares?

"A No, it didn't occur to me."

MacMillen also testified (A-335) that he informed his immediate superior that the stock could not be sold without obtaining "SEC clearance," and Faulkner's other trader, Lattuga, admits that he also knew that fact (A-357).

Lattuga's Testimony

Lattuga, who was still employed by Faulkner when he testified, bent every effort to demonstrating that Santangelo had told him that his stock was not part of any secondary (A-362, 368). He maintained this posture until, in the face of an application for a ruling (A-370), Faulkner's counsel produced a contemporaneous memorandum prepared by Lattuga and MacMillen in June or July 1971 (A-450-51). The traders' contemporaneous memorandum confirmed that Santangelo had said that his stock was not part of the secondary, and thus tied into MacMillen's testimony that Santangelo was being asked specifically about the Leason secondary, the only one of which the Faulkner traders had knowledge (A-288, 324).

With the production of the contemporaneous memorandum, Lattuga's former certainty as to what Santangelo had allegedly told

told him vanished (A-373, 380). Like MacMillen, Lattuga eventually admitted that he himself had first mentioned the Leason secondary to Santangelo and that Santangelo had merely responded to a direct inquiry (A-361).

The testimony of Lattuga also confirms that both MacMillen and Santangelo had told him that Santangelo was waiting for "SEC clearance" (A-360). Lattuga admits he never inquired as to what "SEC clearance" might mean (A-377). When asked what he understood the term "SEC clearance" to mean, he responded that he thought that Santangelo "wanted to make sure he could sell this stock and in no way . . . be involved in this secondary" (A-357). Asked which secondary he was referring to, Lattuga responded "The one that was coming out then. I only thought there was one" (A-288, 324).

Moreover, although Lattuga testified that he telephoned Vincent Ross of Tobey & Kirk between the trade and settlement dates, pursuing a rumor that Tobey & Kirk was selling stock in a secondary (A-386), the memorandum of the traders confirms MacMillen's testimony (A-267-68, 288, 295-96) that Lattuga was calling Ross about a rumor that Tobey & Kirk was selling a block of unregistered stock. The memorandum states (A-450-51):

> "After hearing rumors that there was a piece of unregistered stock around I asked head order clerk at Tobey & Kirk about stock---he said it was and [sic; 'an'] uncoordinated wrap around secondary---I asked him what that was---he said he didn't know---I then told F[rank] Powers not to accept stock." (Emphasis added).

Confronted with this written admission, Lattuga commenced an obviously hopeless effort to redefine the term "unregistered" so as to include within it stock in a registered secondary distribution. Evidently he thought better of it and abandoned the effort, preferring to brand as inaccurate the contemporaneous memorandum prepared two years before and admittedly "written right afterwards" (A-380), which he had previously testified was an accurate reflection of the facts (A-376). He said (A-381) that the term "unregistered to me at the time would take on a broad sense of --" then broke off, saying "I would think I should have corrected it there. . . . I think the word unregistered is incorrect." Yet "unregistered" was the word used by MacMillen in his testimony describing the rumor (A-295).

Indeed, Lattuga's own testimony, although obviously slanted, virtually confirms that this is so because he testified (A-386) that in response to his putative question as to whether the stock he had bought was "part of a secondary" Ross answered "'no', it was an uncoordinated wrap-around secondary," an answer which would be appropriate if the question had related to unregistered stock, but would be inane if the question related to stock in a secondary.

Green's Testimony

Faulkner's house counsel, Marc R. Green, was not a participant to the several conversations leading up to the trade. Nonetheless his testimony concerning the events immediately following the cancellation are revealing, if only by negative

pregnant, of the contrived character of Faulkner's present Rule 10b-5 contentions.

Green admits having had telephone conversations with Vincent Ross of Tobey & Kirk, with counsel for Tobey & Kirk and a lawyer for plaintiff Byrnes (A-398, 400, 403), and of having had a meeting with the several principals on June 21, 1971, to discuss the cancellation (A-409). He admits that he was prepared to consider possible legal avenues for going through with the trade (A-415).

Green admits that in none of these conversations or at the meeting did he or any other Faulkner representative accuse plaintiffs of having misrepresented the registered character of their stock (A-416, 419), although at the meeting the "misunderstanding" had become manifest (A-411). He conceded that the sole ground which he had assigned for the cancellation in all of these conversations was the Jaffee Rule, saying it "encompassed everything that was transpiring here, and was easy to say with one word" (A-402; cf., A-398, 400, 401). He admits that the several attorneys disagreed with his reading of Jaffee, a fact which did not shock him (A-406).

All of these learned discussions about the meaning and application of an obscure SEC Release would have been totally irrelevant and unnecessary if at that time Green actually believed that there had been violations of Rule 10b-5 by plaintiffs since, regardless of Jaffee, Faulkner was free to refuse to contract to buy distribution stock and claims it would not have done so had

it known the facts. Yet Green testified that he had learned of the plaintiffs' alleged misrepresentations from the traders even before the meeting of June 21, 1971 (A-405). When asked what, precisely, the traders had told him, he was prevented from testifying on grounds of attorney-client privilege (A-417-19; 432-33).

Green's testimony thus confirms that there has never been any legitimate basis for accusing plaintiffs of having misrepresented or omitted to disclose the fact that their stock was part of a registered distribution. There is no factual dispute relating to the First Affirmative Defense, and the Court below erred in refusing to grant summary judgment to plaintiffs thereon.

POINT V

SUMMARY JUDGMENT SHOULD HAVE BEEN GRANTED TO PLAINTIFFS AS TO FAULKNER'S SEVENTH AFFIRMATIVE DEFENSE BECAUSE FAULKNER ADDUCED NO EVIDENCE THAT IT WAS PREJUDICED BY PLAINTIFFS' DELAY IN COMMENCING RESALES OF THE STOCK

The Seventh Affirmative Defense asserted by Faulkner complains of plaintiffs' six week delay in commencing resales of the rejected stock, and would hold plaintiffs to the damages they sustained on the date of the initial rejection. Recognizing that no decision on the Seventh Defense was necessary in light of the dismissal of plaintiffs' counterclaims by virtue of the ruling on the Second Defense, Judge Werker nevertheless held, CCH Sec.L. Rep. ¶ 95,463, at p. 99,356 (A-22), that "the reasonableness of the plaintiffs' conduct is a question of fact which cannot be determined in a motion for summary judgment."

Nevertheless, in light of what proved to be the "final" rejection on June 23, 1971, Judge Werker held (A-22), that "It cannot be argued, however, that by failure to sell out immediately after June 23, 1971, the plaintiffs were acknowledging an acceptance of Faulkner's refusal to consummate the transaction." Thus the duty to resell started on June 23, 1971, at the earliest.

Plaintiffs are suing Faulkner for the difference between the contract price of $14 per share and the amounts they actually realized in reselling the stock in the over-the-counter market, a measure of damages which is entirely appropriate. See UCC § 2-706. Under the New York law, "A proper resale sets the absolute measure of the seller's damage, and is not merely evidence of his damages, as is the case under the Uniform Sales Act." Hawkland, Sales and Bulk Sales, ABA/ALI Series Practicing Handbook, p. 150 (2d ed. 1958).

Faulkner's argument is that the law of New York placed upon plaintiffs the obligation to mitigate their damages by reselling their stock within a reasonable time. Faulkner reads Judge Levett's opinion in Bache & Co., Inc. v. International Controls Corp., 339 F.Supp. 341 (S.D.N.Y. 1972), aff'd, on opin. below, 469 F.2d 696 (2d Cir. 1972), for the proposition that "reasonableness" relates to time alone, and that plaintiffs' delay in commencing their resales for more than one month is per se not "reasonable." Accordingly, Faulkner argues that plaintiffs' failure to resell within one month limits them to such damage as they would have sustained on the settlement date, June 15, 1971, relying on UCC § 2-708(1)(F.Memo., R. 23, pp. 84-85).

Of course, Bache v. ICC, supra, 339 F.Supp. at 351, does not hold that a resale more than one month after the breach is unreasonable as a matter of law. Rather, quoting the official comments to UCC 2-706(2), the Court there noted, loc.cit., that the "reasonable resale" obligation is designed "to realize as high a price as possible in the circumstances," and as to the time of resale said, "its length cannot be measured by any legal yardstick or divided into degrees." On the facts of the Bache case, Judge Levet found that "one month" was reasonable.

In Mayer v. Monzo, 221 N.Y. 442, 446-47 (1917), the New York Court of Appeals held sixty days to be reasonable, and that under the NASD Emergency Rules of Fair Practice No. 70-2(II), in force during the relevant period, liquidation by an NASD broker-dealer of a "fail to deliver" or "fail to receive" account between broker-dealers was required to be effected within 120 days. Cf., Hagen Investments, Inc., SEC Release No. 9325 (Sept. 7, 1971), '71-'72 CCH Sec.L.Rep. ¶ 78,302. The resales in suit were commenced and completed, i.e., "liquidated" within ninety days.

Moreover, under UCC § 8-107(2), a new provision dealing exclusively with sales of securities, and one which is unique to the New York law, the plaintiffs were under no obligation whatever to resell the stock. They could have held the rejected stock for Faulkner's account and sued for the full purchase price of $616,000, Bache v. ICC, supra, 339 F.Supp. at 348-49, in which case Faulkner would be entitled to receive the stock, which was quoted at $1-3/4

bid, $2 asked, on May 6, 1976, the date judgment was entered. Given the purpose of the UCC as expressed in § 1-106---that the Code be construed "to the end that the aggrieved party may be put in as good a position as if the other party had fully performed" ---any resale by plaintiffs necessarily mitigated damages and redounds to Faulkner's benefit.

Moreover, UCC § 2-708(2) provides in essence for full recovery of plaintiffs' loss if recovery under section 2-708(1) ---the section invoked by Faulkner to fix damages as of the settlement date---is inadequate fully to compensate them. Recovery under § 2-708(1) would plainly be both inadequate and inequitable on the facts of the present case if for no other reason than that Faulkner kept plaintiffs dangling until June 23, 1971, before "finally" rejecting the transaction as "illegal"---a rejection which followed a further sharp decline in the market price of White Shield, after a press release concerning an unsuccessful drilling off the coast of Sumatra on June 22, 1971 (A-171-74).

While we speak of June 23, 1971 as the "final" rejection because, with hindsight, we know that that is what it was, in the days following the telephone conversation of June 23, 1971, when Mr. Green of Faulkner informed Vincent Ross of Tobey & Kirk that the transaction was "illegal," there was no assurance whatever that Faulkner might not yet go through with the transaction. Faulkner had equivocated between the time of its original rejection on June 15, 1971, and the "final" rejection---its willingness to consider ways in which it might lawfully be able to take the

stock precisely reflecting upturns in the market price of White Shield stock, and its counsel's conclusions that the transaction was illegal exactly mirroring market declines.

Plaintiffs themselves attended a meeting at Faulkner's offices on June 21, 1971, to discuss the controversy (A-105-06). At that meeting, Faulkner had promised to see if there was any way for it lawfully to go through with the transaction notwithstanding Jaffee (A-167, 177, 238). Plaintiffs accordingly instructed Tobey & Kirk to pursue the matter with Faulkner through its own attorneys, and Ross regularly inquired of Tobey & Kirk's attorneys as to the progress of their putative discussions with Mr. Green (A-251-52).

Vincent Ross testified that at the June 21 meeting Mr. Green had said "that if there was any way for Faulkner to take the stock, they would try to do so" (A-249); that there was nothing for Ross to do since Tobey & Kirk's attorneys "had been informed, . . . [were] in contact with Mr. Green, and that they were having their own conversations back and forth" (ibid.); that he personally did not want to "get in the middle of discussions between lawyers" (A-251); and that Ross was in contact with Tobey & Kirk's attorney "every day or so, and just asked him if there was any new developments" (ibid.). He testified that it was not until around August 9, 1971 that he was advised by Tobey & Kirk's counsel that there was no hope (A-252). This is confirmed by Tobey & Kirk's then counsel (A-197, ¶ 11).

Ross further testified that he was being pressed by the plaintiffs for results from these contacts, and that plaintiffs "wanted to get [the] stock sold out [but] We didn't sell any because we were waiting for our answer" from Faulkner (A-251-52).

The reliance upon attorneys was entirely appropriate in the circumstances. As Green himself admitted (A-402), the rejection of the stock itself had been based upon Faulkner's counsel's reading of Rule 10b-6 as construed in Jaffee. The nature of the dispute---whether the transaction could validly be consummated---involved an unprecedented legal question and it reasonably appeared that initial reactions might yet be tempered by a review of the complex legal questions involved.

It is thus not without significance that while Mr. Green left the distinct impression that he would consider the legal questions, he testified that at no time during the summer of 1971 did he bother to reread Jaffee or otherwise ascertain whether the legal position he had invoked was a meritorious one (A-406-07), saying "I really don't need any reassurance, but I don't recall" (A-406-07, 424). While Green testified (A-440-41) that the market price of White Shield played no part in his decision, it is clear merely by reference to the high bid in the Pink Sheets on June 15, 1971 that Faulkner's paper loss on the 44,000 share block of stock was at least $55,000. The market price rallied during the following week, and Green told plaintiffs and Ross that he would see if there was a lawful way to take the stock. On June 22, 1971 a press release further depressed the

price, increasing Faulkner's paper loss to at least $143,000 (A-108), at which time Green concluded that the transaction was "illegal"---without even rereading the Jaffee decision upon which he based the claim of illegality.

Secondly, Vincent Ross testified unequivocally that the market in White Shield stock was very depressed during the summer and there were no sizeable bids for the stock (A-252-53), a not surprising fact since the four registration statements which became effective in the first two weeks of June 1971 had registered an aggregate of 2,303,791 shares of White Shield stock, and vastly increased the "float" in that security (A-129).

Moreover, just as the market break following the unfavorable press release of June 22 explains Faulkner's walking away from the transaction, so also it should excuse plaintiffs' failure to resell immediately, while the market was depressed. Their object was to attempt to get as high a price as possible for their stock, so that dumping it on receipt of bearish news would have been unwise and unreasonable, and would have increased the damages. Judge Werker implicitly recognized as much, CCH at p. 99,356 (A-22)(see ante, p. 82).

From the earliest legitimate date on which the duty to resell might be deemed to have arisen, June 23, 1971, to the commencement of resales on August 9, 1971, is a period of a little more than six weeks which spanned the summer doldrums during which people are on vacation and stock market activity typically is slow. According to Ross's testimony (A-251-52), the market in

White Shield stock was particularly sluggish, and there were no sizable bids for the stock (A-259-60). Asked about market conditions during July 1971, Vincent Ross testified (ibid.) that "there was an awful lot of stock in the market and I am not sure it could have taken an extra 44,000 shares," adding that if such a large block of stock were "just being dumped down" it would have resulted in "driving the stock considerably lower." The issue is whether plaintiffs' delay in commencing to resell was unreasonable as a matter of law, and whether it measurably affected the amount of plaintiffs' damages.

It is also pertinent to note that during a longer period (June 1 through October 15, 1971), Singer & Mackie purchased approximately 125,000 shares of White Shield (Answer to Interrogatory # 1(g))(A-91), presumably as part of its normal market-making operations in which a profit of a fraction of a point on a trade is desirable irrespective of whether the purchase price is high or low. In contrast, plaintiffs were "under the gun," and had to obtain as high a price as possible. Notwithstanding the absence of the pressure which plaintiffs were under, and during a slightly longer period, Singer & Mackie purchased just less than three times the number of shares which plaintiffs were obliged to resell. This evidence confirms Ross's testimony that the market for White Shield was sluggish and that a large sell order would have depressed the price and increased the damages.

Pertinent to Tobey & Kirk's efforts to resell this block is another significant factor bearing on the salability of

plaintiffs' stock during June and July 1971. This was the fact that rumors had been circulated, at least in part by Faulkner (A-390-91), to the effect that the stock being sold by Tobey & Kirk or plaintiffs was not "good, clean stock". Lattuga's testimony (A-450-51), itself confirms that there were "rumors" and he testified that the "rumor" pertained to the stock's being part of a secondary (A-386). In cancelling its resale to Singer & Mackie and Mitchum, Jones & Templeton, Faulkner gave currency to the rumor by telling Singer & Mackie and Mitchum, Jones that Tobey & Kirk was selling distribution stock (A-106, # 26).

Such rumors undoubtedly adversely affected the ability of plaintiffs and Tobey & Kirk to dispose of the rejected stock by eliminating as potential purchasers at least the two market-makers to whom the information was admittedly given. Moreover, since the rumor involved "unclean" stock, and since that term can mean virtually anything at all to traders (if Lattuga (A-351-52) and MacMillen (A-273-76) are typical), and "takes in the whole perspective" (Lattuga, A-366), it is likely that a number of other market-makers---necessarily a close-knit group likely to exchange information of mutual interest for their mutual protection---were also made wary of any White Shield stock being offered by Tobey & Kirk.

On this subject, Ross testified that even at the time the original sales of plaintiffs' stock were completed around June 10 or 12, 1971, before the rejections by Faulkner and Singer, "two or three other brokers", all of whom were in the Pink Sheets,

said "that Faulkner and Singer had spread it all around [that the stock was not 'clean stock'], and it may have been two or three other brokers that said 'I just don't want to get involved.'" (A-263-64, internal quotes added).

"Two or three others", when added to Faulkner and Singer & Mackie---and presumably Mitchum, Jones & Templeton---makes five or six market-makers who would not deal with Tobey & Kirk or buy plaintiffs' stock. That was a significant portion of the available market in June and July 1971. During two-thirds of the thirty-one trading days between June 23, 1971 and August 9, 1971 (both exclusive), there were twelve or thirteen market-makers in the Pink Sheets (A-108-09). Thus, realistically, we are dealing with the poisoning of between 38% and 50% of the available market (using twelve market-makers as a test figure), as a result of the rumors given currency by Faulkner, Singer & Mackie and/or Mitchum Jones.

Given both the general weakness of the market resulting from the large supply of stock, and Faulkner's having poisoned the well, a six-week hiatus between what ultimately proved to be the final repudiation of the agreement on June 23, 1971, and plaintiffs' commencement of the resale of the stock should not constitute an unreasonable delay, as a matter of law, even if the delay is chargeable to the plaintiffs themselves. As we have noted, they and Ross himself believed that the dispute was under discussion between attorneys.

Moreover, there is no demonstrable prejudice whatsoever to Faulkner resulting from plaintiffs' delay for six weeks in commencing to resell their stock. We would expect Faulkner to argue that there were days within that six-week period on which the published high and low bids were higher than the Pink Sheet quotations during the period in which plaintiffs actually did resell. However, while it is appropriate to examine the Pink Sheets as evidence of market trends, cf., Merritt, Vickers, Inc. v. SEC, 353 F.2d 293, 296 (2d Cir. 1965), we submit that they are completely non-probative either of actual trading prices obtainable or of actual sales, particularly on the question of the price at which a large block of stock could have been sold on any given day.

As Judge Frankel observed in Opper v. Hancock Securities Corp., 250 F.Supp. 668, 675 (S.D.N.Y. 1966), aff'd., 367 F.2d 157 (2d Cir. 1966), in some respects Pink Sheet quotations are inaccurate even before they are published:

> "As used in this contention, the 'market' is the range of 'bid' and 'asked' prices reported by brokers making the market in over-the-counter securities. These figures, published daily by the National Quotation Bureau in what initiates call the 'pink sheets,' represent, respectively, the approximate prices at which such brokers may be ready to purchase or sell the stock. The reported figures are no certain indication of prices at which trades have been, or will be, made. Both the quoted prices and the prices actually paid in specific sales are likely to fluctuate in the course of a day and to be inaccurate reflectors even before they are published."

As may be seen in Addendum "C" to this Brief which contrasts the actual resales of plaintiffs' rejected stock vis a vis

the published Pink Sheet prices on the dates of the resales,* the Pink Sheets were not an accurate gauge of the price at which White Shield stock could be sold, even in small lots, or, a fortiori, of the price at which plaintiffs could have resold a block as large as the 45,500 shares rejected by the two defendants. Yet, the Seventh Affirmative Defense, necessarily, if implicitly, suggests that because the Pink Sheet prices were higher on June 23, 1971 than they were on August 9, 1971 and thereafter, that such circumstances create an issue of fact warranting trial as to whether plaintiffs acted "reasonably."

Of the seventeen days on which resales were conducted on behalf of the plaintiffs for Faulkner's account, on eight of them some or all of the stock was resold at prices above the high bid price in the Pink Sheets for that day, while on three days the price received was below the low bid price for the day in the Pink Sheets. By selling out in small lots, 18,600 shares (or 42.3% of the number resold for Faulkner's account) was resold at prices above the high bid price in the Pink Sheets, while only 4,000 shares (or less than 10% of the shares resold for Faulkner's account) were resold at prices below the low bid in the Pink Sheets. Thus the resales themselves were reasonably conducted.

It is axiomatic that a wrongdoer who, by his conduct, makes the ascertainment of the precise amount of the damages

---

*The Pink Sheet "high and low bid" prices are set forth at (A-109-10). The Byrnes resales are at (A-170). The Santangelo resales are contained in Exhibit 11 to his affidavit but have been omitted from the Appendix. They may be found in R. 51.

difficult or impossible does not thereby escape liability. Eastman Kodak Co. v. Southern Photo Materials Co., 273 U.S. 359, 379 (1927); Story Parchment Co. v. Paterson Parchment Co., 282 U.S. 555, 563 (1931); Bigelow v. RKO Radio Pictures, Inc., 327 U.S. 251, 264 (1946); cf., Zeller v. Bogue Elec. Mfg. Co., 476 F.2d 795, 803 (2d Cir. 1973). The difficulties of computation which the wrongdoer helped to create are resolved against him. Cf., Sarlie v. E. L. Bruce Co., 265 F.Supp. 371, 376 (S.D.N.Y. 1967), cited with approval in Chasins v. Smith, Barney & Co., 438 F.2d 1167, 1173 (2d Cir. 1970). And see, Bird v. Ferry, 497 F.2d 112, 113 (5th Cir. 1974):

> "An additional complaint that the evidence is insufficient to support the damages found is meritless; it may be that the proof falls short of mathematical precision. A host of cases holds it may[,] and still suffice."

Our suggestion that Faulkner should be treated as a wrongdoer does not flow from the fact that it ostensibly relied upon an ambiguous release of the Commission and was proved wrong when the Commission's interpretation was subsequently judicially overruled. Rather, the objective evidence is that Faulkner's house counsel only purported to rely upon Jaffee---not even bothering to reread it when knowledgeable securities lawyers suggested to him that his reliance was misplaced---and appears to have been watching the market trends, rejecting the stock only after bad news made it unlikely that the market price would recover in the foreseeable future. Moreover, Faulkner compounded its wrongdoing by defaming the stock being offered by Tobey &

Kirk, both in an effort to justify its decision to terminate the contract with plaintiffs, and to justify cancelling its own resales.

No prejudice to Faulkner having been shown, plaintiffs should have had summary judgment on the Seventh Defense.

POINT VI

THE COURT BELOW ERRED IN DISMISSING THE COMPLAINT FOR LACK OF SUBJECT MATTER JURISDICTION

Plaintiffs brought the action below for a declaratory judgment of the insufficiency of several unprecedented federal "defenses" actually asserted in plaintiffs' state court action for breach of contract, which the parties stayed by agreement. Judge Gurfein sua sponte dismissed the complaint for lack of subject matter jurisdiction, allowing plaintiffs to replead their claims as a counterclaim to Faulkner's counterclaims. Having withdrawn its counterclaims,* Singer & Mackie was dropped from the case for lack of federal subject matter jurisdiction of that defendant, 362 F.Supp. 864, 869-70 (A-30-31).

The primary thrust of Judge Gurfein's decision is that an anticipated federal defense does not confer subject matter jurisdiction. Citing Gully v. First National Bank, 299 U.S. 109, 115 (1936), Judge Gurfein said "Raising a claim based on a federal statute as a matter of defense will not support removal," 362 F.Supp. at 867 (A-28).

---

*The Court did not consider whether the jurisdiction which vested by virtue of Singer's counterclaims remained notwithstanding the amendment eliminating them.

The Gully rationale is inapposite, given the nature of the remedies created by the Securities Act and the Exchange Act, as set forth in A. C. Frost & Co. v. Coeur D'Alene Mining Co., supra, 312 U.S. 38, 41-43 (1941)(quoted ante, p. 50). Although the alleged violations of the two statutes are pleaded in a "Defense," defendants in fact invoke an affirmative remedy or right of action under section 29(b) of the Exchange Act, 15 U.S.C. § 78cc(b), and sections 12 and 14 of the Securities Act, 15 U.S.C. §§ 77l, 77n, which, upon a proper factual showing entitles them to rescind the contracts for sale of securities.

Declaratory judgment is a proper remedy under the Exchange Act. Although Judge Gurfein left open the question of whether defendants could have sued for a declaration that plaintiffs violated the Act, 362 F.Supp. at 869 nt. 4 (A-30), the Supreme Court has recognized the propriety of the procedure. In Cort v. Ash, 422 U.S. 66, 79-80 nt. 11 (1976), referring to J. I. Case Co. v. Borak, 377 U.S. 426 (1964), the Court said:

> "In Borak, § 27 of the Securities and Exchange Act of 1934 specifically granted jurisdiction to the district courts over civil actions to 'enforce any liability or duty created by this title or the rules and regulations thereunder,' and there seemed to be no dispute over the fact that at least a private suit for declaratory relief was authorized; the question was whether a derivative suit for rescission and damages was also available. . . ." (Emphasis added).

In Borak itself, 377 U.S. at 433-35, the Supreme Court held that a private action for damages could be implied for violation of the Exchange Act because "if federal jurisdiction

were limited to the granting of declaratory relief, victims of deceptive proxy statements would be obliged to go into state courts for remedial relief." (Emphasis added). The holding that a damage remedy can be implied because the declaratory remedy may prove to be inadequate is scarcely a holding that declaratory relief is unavailable under the Exchange Act. If defendants had the right to sue for declaratory relief or for rescission under section 29(b) of the Exchange Act, bottoming subject matter jurisdiction on the Exchange Act, mutatis mutandis, plaintiffs should have a correlative right to invoke the Declaratory Judgment Act for a declaration of their non-liability, also basing subject matter jurisdiction on the Exchange Act.

Such a procedure was implicitly recognized by the Supreme Court in Foremost-McKesson, Inc. v. Provident Securities Co., 423 U.S. 232 (1976), where plaintiff had no claim for affirmative relief under the Exchange Act. However, having realized a profit from the purchase and sale of defendant's securities within a six month period, plaintiff was a prospective defendant to an action under section 16(b) of the Exchange Act, 15 U.S.C. § 78p(b). Rather than wait to be sued, plaintiff brought its own action for a declaratory judgment of non-liability, claiming subject matter jurisdiction under the Exchange Act.* Like the Ninth Circuit, 506 F.2d 601 (9th Cir. 1974), and the District Court, 331 F.Supp. 787 (N.D. Cal. 1971), the Supreme Court assumed

---

*No other jurisdictional basis is alleged. The declaratory plaintiff was a dissolved California corporation, and the defendant was a Maryland corporation with its principal place of business in California, so that there was no diversity of citizenship.

without discussion that jurisdiction of the subject matter had properly been invoked and affirmed the granting of the declaratory judgment of non-liability prayed for in the complaint.

No reason of policy dictates a contrary conclusion here. Although Judge Gurfein appeared to be concerned about comity, and with the non-removability policy of section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), 362 F.Supp. at 866-68 (A-27-29), those considerations have no proper place in the case. By hypothesis the federal courts have exclusive jurisdiction of the Exchange Act aspects of the case, 15 U.S.C. § 78aa. As to the non-removability of a Securities Act claim, plaintiffs had not brought their state court action under that Act. Even had they done so, however, the only discernible congressional purpose in making Securities Act actions non-removable was to give plaintiffs their choice of venue. Pinto v. Maremont Corp., 326 F.Supp. 165, 167 nt. 2 (S.D.N.Y. 1971). If both parties are willing to leave a removed Securities Act claim in federal court, no issue of comity arises. Since the federal court has original jurisdiction of such claims there is no warrant for remanding absent a motion to remand.

That the procedure below is unusual and "ingenious," 362 F.Supp. at 867 (A-28), is no ground for denying its use in a proper case. Borak, supra, 377 U.S. at 433-35, taught that where federally created rights and liabilities are involved, it is the duty of the federal courts to "be alert to provide such remedies as are necessary to make effective the congressional purpose" and

"to utilize any of the procedures or actions normally available to the litigant according to the exigencies of the particular case" particularly if "the hurdles that the victim might face [in a state court] . . . might well prove insuperable to effective relief."

The complexity, novelty and difficulty of the federal questions raised below made it inappropriate for them to be determined in the first instance by a state court, with the only possibility of review by a federal court by way of a petition for certiorari to the Supreme Court. Cf., 362 F.Supp. at 868 (A-29). The declaratory judgment complaint was proper and the Court below had subject matter jurisdiction under the Exchange Act. The dismissal of the complaint was erroneous and should be reversed.

CONCLUSION

THE JUDGMENT BELOW SHOULD BE REVERSED, AND THE COURT BELOW DIRECTED TO ENTER JUDGMENT FOR PLAINTIFFS, DISMISSING FAULKNER'S FIRST, SECOND, THIRD AND SEVENTH DEFENSES, AND GRANTING PLAINTIFFS THE DECLARATORY RELIEF AND DAMAGES PRAYED FOR IN THEIR COUNTERCLAIM. THE ORDER DISMISSING THE COMPLAINT AGAINST SINGER & MACKIE, INC., SHOULD BE REVERSED.

Respectfully submitted,

CARRO, SPANBOCK, LONDIN, RODMAN & FASS
Attorneys for Plaintiffs and Counterclaim Defendants-Appellants Thomas J. Byrnes and Francis R. Santangelo
10 East 40th Street
New York, New York 10016
Tel. (212) 889-3600

REGINALD LEO DUFF,
Of Counsel.

ADDENDA

SECURITIES ACT OF 1933

BEST COPY AVAILABLE

Section 2:

§ 77b. Definitions

When used in this subchapter, unless the context otherwise requires—

(4) The term "issuer" means every person who issues or proposes to issue any security; except that with respect to certificates of deposit, voting-trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors (or persons performing similar functions) or of the fixed, restricted management, or unit type, the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; except that in the case of an unincorporated association which provides by its articles for limited liability of any or all of its members, or in the case of a trust, committee, or other legal entity, the trustees or members thereof shall not be individually liable as issuers of any security issued by the association, trust, committee, or other legal entity; except that with respect to equipment-trust certificates or like securities, the term "issuer" means the person by whom the equipment or property is or is to be used; and except that with respect to fractional undivided interests in oil, gas, or other mineral rights, the term "issuer" means the owner of any such right or of any interest in such right (whether whole or fractional) who creates fractional interests therein for the purpose of public offering.

(10) The term "prospectus" means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security; except that (a) a communication sent or given after the effective date of the registration statement (other than a prospectus permitted under subsection (b) of section 77j of this title) shall not be deemed a prospectus if it is proved that prior to or at the same time with such communication a written prospectus meeting the requirements of subsection (a) of section 77j of this title at the time of such communication was sent or given to the person to whom the communication was made, and (b) a notice, circular, advertisement, letter, or communication in respect of a security shall not be deemed to be a prospectus if it states from whom a written prospectus meeting the requirements of section 77j of this title may be obtained and, in addition, does no more than identify the security, state the price thereof, state by whom orders will be executed, and contain such other information as the Commission, by rules or regulations deemed necessary or appropriate in the public interest and for the protection of investors, and subject to such terms and conditions as may be prescribed therein, may permit.

(11) The term "underwriter" means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

(12) The term "dealer" means any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person.

§ 77d. Exempted transactions

The provisions of section 77e of this title shall not apply to—

(1) transactions by any person other than an issuer, underwriter, or dealer.

(2) transactions by an issuer not involving any public offering.

(3) transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction), except—

(A) transactions taking place prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter,

(B) transactions in a security as to which a registration statement has been filed taking place prior to the expiration of forty days after the effective date of such registration statement or prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter after such effective date, whichever is later (excluding in the computation of such forty days any time during which a stop order issued under section 77h of this title is in effect as to the security), or such shorter period as the Commission may specify by rules and regulations or order, and

(C) transactions as to securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution of such securities by the issuer or by or through an underwriter.

With respect to transactions referred to in clause (B), if securities of the issuer have not previously been sold pursuant to an earlier effective registration statement the applicable period, instead of forty days, shall be ninety days, or such shorter period as the Commission may specify by rules and regulations or order.

(4) brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders.

§ 77e. Prohibitions relating to interstate commerce and the mails

(a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this subchapter, unless such prospectus meets the requirements of section 77j of this title; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 77j of this title.

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77h of this title.

§ 77g. Information required in registration statement

The registration statement, when relating to a security other than a security issued by a foreign government, or political subdivision thereof, shall contain the information, and be accompanied by the documents, specified in Schedule A of section 77aa of this title, and when relating to a security issued by a foreign government, or political subdivision thereof, shall contain the information, and be accompanied by the documents, specified in Schedule B of section 77aa of this title; except that the Commission may by rules or regulations provide that any such information or document need not be included in respect of any class of issuers or securities if it finds that the requirement of such information or document is inapplicable to such class and that disclosure fully adequate for the protection of investors is otherwise required to be included within the registration statement. If any accountant, engineer, or appraiser, or any person whose profession gives

authority to a statement made by him, is named as having prepared or certified any part of the registration statement, or is named as having prepared or certified a report or valuation for use in connection with the registration statement, the written consent of such person shall be filed with the registration statement. If any such person is named as having prepared or certified a report or valuation (other than a public official document or statement) which is used in connection with the registration statement, but is not named as having prepared or certified such report or valuation for use in connection with the registration statement, the written consent of such person shall be filed with the registration statement unless the Commission dispenses with such filing as impracticable or as involving undue hardship on the person filing the registration statement. Any such registration statement shall contain such other information, and be accompanied by such other documents, as the Commission may by rules or regulations require as being necessary or appropriate in the public interest or for the protection of investors.

§ 77j. Information required in prospectus

(a) Except to the extent otherwise permitted or required pursuant to this subsection or subsections (c), (d), or (e) of this section—

(1) a prospectus relating to a security other than a security issued by a foreign government or political subdivision thereof, shall contain the information contained in the registration statement, but it need not include the documents referred to in paragraphs (28) to (32), inclusive, of schedule A of section 77aa of this title;

(2) a prospectus relating to a security issued by a foreign government or political subdivision thereof shall contain the information contained in the registration statement, but it need not include the documents referred to in paragraphs (13) and (14) of schedule B of section 77aa of this title;

(3) notwithstanding the provisions of paragraphs (1) and (2) of this subsection when a prospectus is used more than nine months after the effective date of the registration statement, the information contained therein shall be as of a date not more than sixteen months prior to such use, so far as such information is known to the user of such prospectus or can be furnished by such user without unreasonable effort or expense;

(4) there may be omitted from any prospectus any of the information required under this subsection which the Commission may by rules or regulations designate as not being necessary or appropriate in the public interest or for the protection of investors.

(b) In addition to the prospectus permitted or required in subsection (a) of this section, the Commission shall by rules or regulations deemed necessary or appropriate in the public interest or for the pro-

tection of investors permit the use of a prospectus for the purposes of subsection (b) (1) of section 77e of this title which omits in part or summarizes information in the prospectus specified in subsection (a) of this section. A prospectus permitted under this subsection shall, except to the extent the Commission by rules or regulations deemed necessary or appropriate in the public interest or for the protection of investors otherwise provides, be filed as part of the registration statement but shall not be deemed a part of such registration statement for the purposes of section 77k of this title. The Commission may at any time issue an order preventing or suspending the use of a prospectus permitted under this subsection, if it has reason to believe that such prospectus has not been filed (if required to be filed as part of the registration statement) or includes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which such prospectus is or is to be used, not misleading. Upon issuance of an order under this subsection, the Commission shall give notice of the issuance of such order and opportunity for hearing by personal service or the sending of confirmed telegraphic notice. The Commission shall vacate or modify the order at any time for good cause or if such prospectus has been filed or amended in accordance with such order.

(c) Any prospectus shall contain such other information as the Commission may by rules or regulations require as being necessary or appropriate in the public interest or for the protection of investors.

(d) In the exercise of its powers under subsections (a), (b), or (c) of this section, the Commission shall have authority to classify prospectuses according to the nature and circumstances of their use or the nature of the security, issue, issuer, or otherwise, and, by rules and regulations and subject to such terms and conditions as it shall specify therein, to prescribe as to each class the form and contents which it may find appropriate and consistent with the public interest and the protection of investors.

(e) The statements or information required to be included in a prospectus by or under authority of subsections (a), (b), (c), or (d) of this section, when written, shall be placed in a conspicuous part of the prospectus and, except as otherwise permitted by rules or regulations, in type as large as that used generally in the body of the prospectus.

(f) In any case where a prospectus consists of a radio or television broadcast, copies thereof shall be filed with the Commission under such rules and regulations as it shall prescribe. The Commission may by rules and regulations require the filing with it of forms and prospectuses used in connection with the offer or sale of securities registered under this subchapter.

§ 77k. Civil liabilities on account of false registration statement

(a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

§ 77*l*. Civil liabilities arising in connection with prospectuses and communications

Any person who—

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

§ 77*s*. Special powers of Commission

(a) The Commission shall have authority from time to time to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of this subchapter, including rules and regulations governing registration statements and prospectuses for various classes of securities and issuers, and defining accounting, technical, and trade terms used in this subchapter. Among other things, the Commission shall have authority, for the purposes of this subchapter, to prescribe the form or forms in which required information shall be set forth, the items or details to be shown in the balance sheet and earning statement, and the methods to be followed in the preparation of accounts, in the appraisal or valuation of assets and liabilities. in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer; but insofar as they relate to any common carrier subject to the provisions of section 20 of Title 49, the rules and regulations of the Commission with respect to accounts shall not be inconsistent with the requirements imposed by the Interstate Commerce Commission under authority of such section. The rules and regulations of the Commission shall be effective upon publication in the manner which the Commission shall prescribe. No provision of this subchapter imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.

SECURITIES EXCHANGE ACT OF 1934

Section 10(b)

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

SEC Rule 10b-5, 17 CFR § 240.10b-5

[¶ 26,744] Reg. § 240.10b-5 (Rule 10b-5) Employment of Manipulative and Deceptive Devices

Reg. § 240.10b-5. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

[¶ 26,745] Reg. § 240.10b-6 (Rule 10b-6) Prohibition Against Trading by Persons Interested in a Distribution

➠ *Reg. § 240.10b-6 is proposed to be amended. See ¶ 22,726. CCH.*

Reg. § 240.10b-6. (a) It shall constitute a "manipulative or deceptive device or contrivance" as used in Section 10(b) of the Act for any person,

(1) who is an underwriter or prospective underwriter in a particular distribution of securities, or

(2) who is the issuer or other person on whose behalf such a distribution is being made, or

(3) who is a broker, dealer, or other person who has agreed to participate or is participating in such a distribution,

directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, either alone or with one or more other persons, to bid for or purchase for any account in which he has a beneficial interest, any security which is the subject of such distribution, or any security of the same class and series, or any right to purchase any such security, or to attempt to induce any person to purchase any such security or right until after he has completed his participation in such distribution; *provided, however,* that this rule shall not prohibit (1) transactions in connection with the distribution effected otherwise than on a securities exchange with the issuer or other person or persons on whose behalf such distribution is being made or among underwriters, prospective underwriters or other persons who have agreed to participate or are participating in such distribution; (2) unsolicited privately negotiated purchases, each involving a substantial amount of such security, effected neither on a securities exchange nor from or through a broker or dealer; or (3) purchases by an issuer effected more than forty days after the commencement of the distribution for the purpose of satisfying a sinking fund or similar obligation to which it is subject; or (4) odd-lot transactions (and the off-setting round-lot transactions hereinafter referred to) by a person registered as an odd-lot dealer in such security on a national securities exchange who offsets such odd-lot transactions in such security by round-lot transactions as promptly as possible; or (5) brokerage transactions not involving solicitation of the customer's order; or (6) offers to sell or the solicitation of offers to buy the securities being distributed (including securities or rights acquired in stabilizing) or securities or rights offered as principal by the person making such offer to sell or solicitation; or (7) the exercise of any right or conversion privilege to acquire any security; or (8) stabilizing transactions not in violation of § 240.10b-7; or (9) bids for or purchases of rights not in violation of § 240.10b-8; or (10) transactions effected on a national securities exchange in accordance with the provisions of a plan filed by such exchange under § 240.10b-2(d) and declared effective by the Commission; or (11) purchases or bids by an underwriter, prospective underwriter or dealer otherwise than on a securities exchange, 10 or more business days prior to the proposed commencement of such distribution (or 5 or more business days in the case of unsolicited purchases), if none of such purchases or bids are for the purpose of creating actual, or apparent, active trading in or raising the price of such security. In the case of securities offered pursuant to an effective registration statement under the Securities Act of 1933 the distribution shall not be deemed to commence for purposes of this clause (11) prior to the effective date of the registration statement.

(b) The distribution of a security (1) which is immediately exchangeable for or convertible into another security, or (2) which entitles the holder thereof immediately to acquire another security, shall be deemed to include a distribution of such other security within the meaning of this rule.

(c) The following shall be applicable for the purposes of this rule:

(1) The term "underwriter" means a person who has agreed with an issuer or other person on whose behalf a distribution is to be made (A) to purchase securities for distribution or (B) to distribute securities for or on behalf of such issuer or other person or (C) to manage or supervise a distribution of securities for or on behalf of such issuer or other person.

(2) The term "prospective underwriter" means a person (A) who has agreed to submit or has submitted a bid to become an underwriter of securities as to which the issuer, or other person on whose behalf the distribution is to be made, has issued a public invitation for bids, or (B) who has reached an understanding, with the issuer or other person on whose behalf a distribution is to be made, that he will become an underwriter, whether or not the terms and conditions of the underwriting have been agreed upon.

(3) A person shall be deemed to have completed his participation in a particular distribution as follows: (A) the issuer or other person on whose behalf such distribution is being made, when such distribution is completed; (B) an underwriter, when he has distributed his participation, including all other securities of the same class acquired in connection with the distribution, and any stabilization arrangements and trading restrictions with respect to such distribution to which he is a party have been terminated; (C) any other person, when he has distributed his participation. A person, including an underwriter or dealer, shall be deemed for purposes of this paragraph (c)(3) to have distributed securities acquired by him for investment.

(d) The provisions of this rule shall not apply to any of the following securities: (1) "exempted securities" as defined in Section 3(a)(12) of the Act, including securities issued, or guaranteed both as to principal and interest, by the International Bank for Reconstruction and Development; or (2) face-amount certificates issued by a face-amount certificate company, or redeemable securities issued by an open-end management company or a unit investment trust. Any terms used in clause (2) of this paragraph (d) which are defined in the Investment Company Act of 1940 shall have the meanings specified in such Act.

(e) The provisions of this rule shall not apply to any distribution of securities by an issuer to its employees, or to employees of its subsidiaries, or to a trustee or other person acquiring such securities for the account of such employees, pursuant to (1) a stock option plan involving only "qualified stock options", or qualifying as an "employee stock purchase plan" as those terms are defined in Sections 422 and 423 of the Internal Revenue Code of 1954, as amended or "restricted stock options" as defined in Section 424(b) of the Internal Revenue Code of 1954, as amended, provided however, that for the purposes of this paragraph an option which meets all of the conditions of that Section other than the date of issuance shall be deemed to be "restricted stock options" or (2) a savings, investment or stock purchase plan providing for both (A) periodic payments (or payroll deductions) for acquisition of securities by participating employees and (B) periodic purchases of the securities by participating employees, or the person acquiring them for the account of such employees.

(f) This rule shall not prohibit any transaction or transactions if the Commission, upon written request or upon its own motion, exempts such transaction or transactions, either unconditionally or on specified terms and conditions, as not constituting a manipulative or deceptive device or contrivance comprehended within the purpose of this rule.

§ 1—106. Remedies to Be Liberally Administered

(1) The remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this Act or by other rule of law.

(2) Any right or obligation declared by this Act is enforceable by action unless the provision declaring it specifies a different and limited effect. L.1962, c. 553, eff. Sept. 27, 1964.

§ 2—706. Seller's Resale Including Contract for Resale

(1) Under the conditions stated in Section 2—703 on seller's remedies, the seller may resell the goods concerned or the undelivered balance thereof. Where the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages allowed under the provisions of this Article (Section 2—710), but less expenses saved in consequence of the buyer's breach.

(2) Except as otherwise provided in subsection (3) or unless otherwise agreed resale may be at public or private sale including sale by way of one or more contracts to sell or of identification to an existing contract of the seller. Sale may be as a unit or in parcels and at any time and place and on any terms but every aspect of the sale including the method, manner, time, place and terms must be commercially reasonable. The resale must be reasonably identified as referring to the broken contract, but it is not necessary that the goods be in existence or that any or all of them have been identified to the contract before the breach.

§ 2—708. Seller's Damages for Non-acceptance or Repudiation

(1) Subject to subsection (2) and to the provisions of this Article with respect to proof of market price (Section 2—723), the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this Article (Section 2—710), but less expenses saved in consequence of the buyer's breach.

(2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (Section 2—710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale. L.1962, c. 553, eff. Sept. 27, 1964.

§ 8—107. Securities Deliverable; Action for Price

(1) Unless otherwise agreed, a person obligated to deliver securities may deliver a like number of units of any securities which by nature or usage of trade are the equivalent of the securities he is obligated to deliver.

(2) Where, pursuant to a contract to sell or a sale, a security has been delivered or tendered to the purchaser, and the purchaser wrongfully fails to pay for the security according to the terms of the contract or the sale, the seller may as an alternative to any other remedy recover the agreed price of the security. This subsection does not affect the remedy of a seller if the security has not been delivered or tendered. L.1962, c. 553; amended L.1964, c. 476, § 5, eff. Sept. 27, 1964.

[¶ 3185] [Copy of Prospectus Received by Purchaser from Source Other than Seller]

Release No. 33-828, June 4, 1936, 11 F. R. 10957.

17 CFR 231.828. Letter of General Counsel discussing the application of section 5(b)(2) where a purchaser has received a copy of a prospectus from a source other than the seller.

It is my opinion that the words, "preceded by a prospectus", in section 5(b)(2) of the Securities Act of 1933, as amended, do not require that the prescribed prospectus must have been sent by the same person who causes the securities to be sent through the mails for the purpose of sale, or for delivery after sale. Such person would, of course, take the risk of the lack of prior transmittal of a prospectus, but, assuming that the purchaser had, in fact, received a copy thereof, it would not be necessary for the seller of the security to transmit additional copies of such prospectus at the time of transmittal of the security.

The above opinion, of course, relates only to the requirements of section 5(b)(2) and not to section 5(b)(1). It should be noted that the latter section provides that any prospectus which is sent through the mails or in interstate commerce must comply with the requirements of Section 10, and that any literature offering a security for sale (other than a notice meeting the requirements of section 2(10)(b)) falls within the definition of "prospectus" contained in Section 2(10), unless the sender thereof or his principal has previously sent or given the prospective purchaser a copy of the prescribed prospectus. Consequently, the receipt by the prospective purchaser of the prescribed prospectus from another source would not relieve a person who is subsequently circulating selling literature from the duty of seeing that such literature, in accordance with the provisions of section 5(b)(1), meets the requirements of section 10 of the Act.

[Release No. 33-828, June 4, 1936, 11 F. R. 10957.]

[¶ 3195] [Issuance of Prospectuses to Customers in Connection with Trading in Registered Securities]

Release No. 33-2623, July 25, 1941, 11 F. R. 10964.

17 CFR 231.2623. Opinion of General Counsel concerning the application of the third clause of section 4(1) in various situations.

I have been asked to express my opinion as to the circumstances under which brokers and dealers must use prospectuses in connection with trading in the securities of American Telephone and Telegraph Company covered by the registration statement which became effective under the Securities Act on July 15, 1941.

[¶ 3196] [Nature of the Offering]

In order to make my discussion more clearly understandable in its application to the various concrete situations which may arise, I shall first describe briefly the nature of the offering in question. The registration statement covered $233,584,900 in principal amount of debentures of the Company, proposed to be offered by the Company pro rata to its existing stockholders, without the intermediation of any underwriters. The statement covered also full and fractional warrants which the Company proposed to deliver to its stockholders in evidence of their right to purchase debentures from the Company. These warrants were to be issued to all stockholders of record at the close of business on July 25, 1941, and the registration statement specified that the warrants would actually be issued to stockholders on or about August 4, 1941. The warrants by their terms were required to be exercised on or before August 29, 1941. Pursuant to an order of the Commission entered on July 11, 1941, the registration statement became effective at 4:45 P. M., E. S. T., on July 15, 1941. So far as practicable, prospectuses were made generally available by the Company on July 16, 1941.

[¶ 3197] [Use of Mails or Instrumentalities of Interstate Commerce]

Before discussing the legal requirements which have been applicable since the registration statement became effective, I should like to point out that until the statement became effective it was illegal for any broker or dealer to use the mails or instrumentalities of interstate commerce to offer or sell either the debentures or the warrants on a when-issued basis. This was clearly stated in a release published by the Commission on July 9, 1941 (Securities Act Release No. 2613). Apparently, it was not sufficiently understood that the prohibition of the statute extended not only to offers and sales for immediate execution, but also to solicitations of orders which were not to be given and executed until after the effective date of the statement. Thus, a circular distributed by a broker or dealer to his customers, describing the debentures and the rights and suggesting that he would be glad to receive and execute orders after the statement became effective, was no less a violation of the statute than a circular inviting the immediate submission of orders before the effective date. The same would be true even if the circular carried a "hedge clause" specifically disclaiming any intent to solicit orders. If the

 © 1973, Commerce Clearing House, Inc.

circular in fact constituted a solicitation of orders it could not be brought within the law by mere formal disclaimers.

Now that the statement has become effective, there is no prohibition against offering rights or debentures, or soliciting orders to buy them, whether on a when-issued or an issued basis. However, the Act requires that if any prospectus relating to a registered security is transmitted through the mails or in interstate commerce, that prospectus must be in the form of, or accompanied or preceded by the formal prospectus filed by the issuer with its registration statement. (For convenience, I shall call this prospectus a "formal prospectus."—In the Act it is referred to as a "prospectus that meets the requirements of section 10.") Furthermore, even if in a particular sale no use is made of the mails or interstate commerce to offer the security, or to solicit orders to buy it, the security itself must still be accompanied or preceded by the formal prospectus when the security is delivered through the mails or in interstate commerce.

[¶ 3198] [Scope of Term "Prospectus"]

In applying these principles to particular situations, brokers and dealers should appreciate that the term "prospectus" as used in the Securities Act covers more than the kind of formal document which the layman ordinarily has in mind when he uses the term. Under the Act a "prospectus" includes every kind of written communication which attempts or offers to dispose of, or solicits an offer to buy, a security for value, or which constitutes a contract of sale or disposition of a security for value. If the term "prospectus" is construed in accordance with its language and spirit, it must in my opinion be read to cover any document which is designed to procure orders for a security, or to effectuate the disposition of a security, whether or not the document purports on its face to offer the security for sale, or otherwise to dispose of it for value.

[¶ 3199] [Concrete Examples]

In the light of these general principles let me discuss concrete examples which will illustrate in greater detail the application of the prospectus requirements of the Act to transactions occurring after the effective date of the registration statement.

Question 1. John Doe, a dealer, writes a letter to Richard Roe, one of his customers, offering him warrants, on a when-issued basis, for ten $100 debentures. Must John Doe send a copy of the formal prospectus with his letter?

Answer. Yes. John Doe's letter itself falls within the broad definition of "prospectus" in the Act. As such, it must, in order to comply with the Act, either be in the form of the formal prospectus—which it obviously is not—or else be preceded or accompanied by a formal prospectus.

Question 2. Instead of writing a letter to Richard Roe, John Doe calls him on the telephone and offers him the warrants. Richard Roe accepts; and John Doe thereupon mails him a confirmation of the sale. Must John Doe send a copy of the formal prospectus with his confirmation?

Answer. Yes. The term "prospectus" is defined in the Act broadly to include within its meaning an ordinary confirmation; and since the confirmation is not itself a formal prospectus, it, like the offering letter in Question 1, must be accompanied or preceded by a formal prospectus.

[¶ 3199] 17 CFR 231.2623—Continued

Question 3.[1] John Doe happens to know that his customer, Richard Roe, is already a stockholder of American Telephone and Telegraph Company, and has therefore already received a prospectus from the Company itself. Must John Doe still, in the situation described in Questions 1 and 2, send Richard Roe a formal prospectus?

Answer.[1] Yes. In requiring that a letter offering registered securities, or a confirmation, must be accompanied or preceded by a formal prospectus, the Act requires further that this formal prospectus shall have been sent or given —not by *anyone*, but by the person who sent the letter or confirmation, or by his principal. John Doe is not acting for American Telephone and Telegraph Company. Consequently, the fact that Richard Roe has received a prospectus from American Telephone and Telegraph Company does not affect the responsibility that John Doe has to comply with the prospectus requirements.

Question 4. On August 5, 1941, John Doe telephones Richard Roe, his customer, and states that he has warrants for ten $100 debentures, and will be glad to sell them to Richard Roe. Richard Roe accepts the offer. John Doe thereupon immediately puts the warrants in an envelope, and mails them to Richard Roe. Must John Doe enclose also a copy of the formal prospectus?

Answer. Yes. The Act requires that registered securities, when delivered through the mails or in interstate commerce, shall be preceded or accompanied by a formal prospectus; and since John Doe made an oral offer, without sending a formal prospectus, he must send one with the warrants.

Question 5. In the course of the conversation described in Question 4, Richard Roe mentions that he is already a stockholder of American Telephone and Telegraph Company, and so has received a copy of the prospectus. Must John Doe nevertheless send him another copy?

Answer. No. In requiring that securities, when delivered, be accompanied or preceded by a prospectus, the Act does not require that the prospectus shall have been sent or given by the person making the delivery. It is enough that the purchaser shall already have received a prospectus from some source. (Owing to the particular wording of the Act, this situation must be carefully distinguished from the case in Question 3.)

Question 6. John Doe, a broker, receives an unsolicited telephone call from Richard Roe, asking him to purchase for Richard Roe's account warrants for ten $100 debentures. John Doe does so and sends them to Richard Roe by mail. Must he send a copy of the prospectus with the warrants?

Answer. No. The prospectus requirements of the Act do not apply to unsolicited brokers' transactions, whether executed on an exchange or over the counter.

Question 7. Richard Roe telephones John Doe, his broker, and states that he has certain warrants which he would like John Doe to sell for his account. John Doe does so, and sends him a confirmation of the transaction. Must John Doe at the same time send him a copy of the prospectus?

[1] Question and answer No. 3 of Release No. 33-2623 are considered to be inoperative because of the 1954 amendment of Section 2(10). [¶ 1451]. CCH.

 © 1973, Commerce Clearing House, Inc.

Answer. No. In confirming a sell order on a brokerage basis, John Doe is not within the prospectus requirements of the Act.

Question 8.[2] Pursuant to the sell order received in Question 7, John Doe sells Richard Roe's warrants to Henry Hoe, another dealer, who purchases for his own account. Must John Doe, in confirming the sale to Henry Hoe, or in delivering the warrants to him, send him a copy of the prospectus?

Answer.[2] No. John Doe, in making the sale, is completing the execution of an unsolicited brokerage order, and therefore is exempt from the prospectus requirements.

Question 9. John Doe writes to his customer Richard Roe, whom he knows to be a stockholder of American Telephone and Telegraph Company and offers to sell for him the warrants he has received. Must John Doe send Richard Roe a formal prospectus with his letter?

Answer. No, since he is offering to sell *for* him, not *to* him.

Question 10.[2] As a result of the letter described in Question 9, Richard Roe gives John Doe a sell order, and John Doe sells the rights to Henry Hoe. When he mails the warrants to Henry Hoe, must he send a copy of the prospectus with them?

Answer.[2] Yes. The transaction, although on a brokerage basis, results from a solicitation, and consequently the prospectus requirements are applicable to John Doe's sale to Henry Hoe.

Question 11. John Doe writes a letter to Richard Roe, his customer, offering to purchase rights for his account. Must John Doe enclose in his letter a copy of the prospectus?

Answer. Yes. Even though John Doe acts as broker in the transaction, he is soliciting an offer to buy, and is therefore subject to the prospectus requirements of the Act.

In an effort to be of the greatest assistance to brokers and dealers in the practical conduct of their business, I have endeavored to state the foregoing illustrative questions and answers in as non-technical a fashion as possible. Anyone desiring more detailed information as to the statutory basis for the answers I have given, or wishing information as to any situations which I have not covered, is welcome to address a further inquiry to this office.

[Release No. 33-2623, July 25, 1941, 11 F. R. 10964.]

[2] Questions and answers No. 8 and 10 of Release No. 33-2623 were superseded by Reg. § 230.154, now rescinded. See ¶ 2985.14. CCH.

dend exclusion of 62.46% from Federal taxable income.

[Utility Preferred Stocks]

Persons desiring retention of the present redemption policy also urge that the market for utility preferred stocks (including the fully refundable issues) continues to be adequate. In support of this assertion, these persons point out that during the period from January 1, 1969 through April 7, 1970 thirteen electric utility companies offered preferred stocks and long-term debt securities simultaneously and that in nearly all of such cases, the dividend costs and yields on the preferred issues were unusually close to the interest costs and yields on the debt securities, considering the greater investment safety of the latter. They further state that, among these simultaneous offerings were four such offerings where the preferred stocks were offered at money costs and yields equal to or lower than the interest costs and yields on the bonds, despite the fact that the debt securities provided five years refunding protection whereas the preferred issues were fully refundable. In only two of the other simultaneous offerings did the offering yield on the preferred exceed that of the bonds by as much as 15 basis points; one of such preferred stocks being fully refundable and the other non-refundable for ten years. In the most recent simultaneous offering, an electric utility subject to the 1935 Act sold $60.0 million of first mortgage 30-year bonds, with five-year refunding protection, and $10.0 million of preferred stock, with no refunding protection, on April 6, 1970. The bonds were offered to yield investors 8.58% and less than one third of the issue was reported sold the first day. The preferred stock was offered to yield 8.66% and was reported sold the first day. As a further indication that the market for fully refundable preferred stock is satisfactory, it is also pointed out that offerings of such issues at competitive bidding during the past few years of tight money supply have continued to attract ample numbers of bids from competing investment bankers. In fact, the $10.0 million preferred issue sold on April 6, 1970 received four bids.

It is acknowledged by the proponents of the present policy that the demands of the utility industry for additional capital in the foreseeable future are likely to continue at the present high level and may even increase in subsequent years. However, it is asserted that the refunding of high dividend rate preferred stock in periods of more favorable markets and the refunding of approaching maturities of the substantial amounts of bonds issued in the 1930's and 1940's should not have more than a temporary impact upon the ability of the industry to obtain such new capital. Such refundings would not add significantly to the total supply of securities outstanding but merely effect substitutions of certain investment securities for others, except for brief periods of time when both the new and refunded issues remain outstanding simultaneously and except for the small amounts of additional funds required for premiums.

All interested persons are invited to submit their views and comments, in writing, to the Securities and Exchange Commission, Washington, D. C. 20549 on or before May 11, 1970. Such communications will be considered available for public inspection unless confidential treatment is specifically requested.

By the Commission.

[¶ 77,805] In the Matters of Jaffee & Co., et al.

Securities and Exchange Act Release No. 8966. April 20, 1970. Findings and Order of the Commission. Opinion in full text.

Broker-dealer Proceedings—Registration Violations—Distribution of Securities—Failure to Deliver Prospectuses.—The wilful failure of a broker-dealer to deliver the prospectus of a new offering before or accompanying the sales thereof violated the Securities Act, and sanctions were appropriate. The broker-dealer sold the securities over a two-month period to other dealers, but failed to send prospectuses. The respondent claimed an exemption under Section 4(1) of the Securities Act as one who was not acting as an underwriter. However, the respondent, as principal, purchased shares from the exclusive agent for the distribution, for resale and, therefore, became a participant in the distribution and also brought itself within the definition of underwriter. The record was devoid of proof that the commissions received were no more than is customary

© 1970, Commerce Clearing House, Inc.

BEST COPY AVAILABLE

for distributors or sellers, or that the purchasers from the respondent had received copies of the prospectus from other sources, the burden of so proving being on the respondent.

See ¶ 1501, "Securities Act—Definitions" division; ¶ 2705, "Securities Act—Exemptions" division and ¶ 3101, "Securities Act—Registration" division, Volume 1.

Broker-dealer Proceedings—Manipulations—Bids and Purchases During Distribution.—The actions of the respondent in purchasing shares of the issuer that were not part of the distribution, while it participated therein as an underwriter, violated the anti-fraud provisions of Rule 10b-6 under the Exchange Act. Also a violation was the respondent's action in submitting bid prices for the stock in the over-the-counter quotation sheets. The contention of the respondent that its transactions constituted a delayed or shelf registration is inapposite to a violation of Rule 10b-6 which prohibits purchases during distribution, whatever the offering is called.

See ¶ 22,726, "Exchange Act—Manipulations" division, Volume 2.

Donald N. Malawsky, William H. Joseph, Gerald Gordon, Robert G. Willner, and Michael Gettelman, of the New York Regional Office of the Commission, for the Division of Trading and Markets.

Jerome J. Londin, of Carro, Spanbock & Londin, for Jaffee & Company and Wilton L. Jaffee, Jr.

Ira M. Millstein, Donald J. Williamson, and Peter D. Standish, of Weil, Gotshal & Manges, and Melvin Katz, for Greene & Company, Irving A. Greene, and Robert Topol.

Raphael P. Koenig, of Koenig and Ratner, for Bernard Horn.

Eric M. Javits, David A. Goldstein, William J. Quinlan, and John C. Moore III, of Javits & Javits, for M. L. Lee & Co., Inc.

Following hearings in these private proceedings pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act"), the hearing examiner filed an initial decision in which he concluded, among other things, that the broker-dealer registrations of Greene & Company ("G Co.") and M. L. Lee & Co., Inc. ("Lee") should be suspended for five days, and that Wilton L. Jaffee, Jr., the principal partner in Jaffee & Company ("J Co."), a registered broker-dealer, should be suspended from association with a broker or dealer for 30 days, Irving A. Greene and Robert Topol, the partners of G Co., for 10 days, and Bernard Horn, who was a trader for G Co., for 20 days. The examiner further concluded that following Horn's suspension he should be restricted to employment in a non-supervisory capacity upon a showing of adequate supervision, and that the proceedings with respect to J Co. should be dismissed.[1] We granted petitions for review filed by all respondents except J Co., and by our Division of Trading and Markets ("Division"), and we ordered review of the examiner's decision with respect to all issues which were before him concerning respondents. Briefs were filed by respondents[2] and the Division and we heard oral argument.[3] Our findings are based upon an independent review of the record.

Bids and Purchases During Distribution

The order for proceedings charges that, between June 1963 and March 1964, respondents willfully violated the anti-manipulation provisions of Rule 10b-6 under Section 10(b) of the Exchange Act in connection with a registered secondary offering of stock of Solitron Devices, Inc. ("Solitron"). Lee was properly appointed the "exclusive agent" for the offering,[4] effective October 11, 1962, of 107,700 shares of Solitron stock, representing about 28% of the shares outstanding, on behalf of 34 selling shareholders. Included among these shareholders were Jaffee, who registered 27,500 shares (the largest block involved), and an officer, a director, and the wives of other officers of Solitron. The shares were to be offered for sale by the individual sellers from time to time "in the proximate

[1] The examiner also dismissed the proceedings with respect to Lee's president, Martin L. Levy, who died following the close of the hearings, and we shall enter an order of dismissal with respect to him. Levy is not included in the term "respondents" as used hereafter

[2] In accordance with a specific request by Lee, we have also considered its proposed findings and brief filed with the hearing examiner.

[3] The requests of various respondents and the Division to make certain corrections in the transcript of the oral argument are granted.

[4] *See Hazel Bishop, Inc.*, 40 S.E.C. 718 (1961).

future" at the prevailing market price as reflected in the over-the-counter market. The prospectus stated that the selling shareholders had advised Solitron that they intended to offer their respective holdings for sale but that there was no assurance that any of such sellers would sell any or all of the shares owned by them. Solitron obtained agreements from Lee and the selling stockholders that they would "comply with the provisions of Rule 10b-6." By May 15, 1963, shortly before the period at issue here, 16,300 shares of Solitron had been sold. By the end of March 1964, Lee on behalf of the selling stockholders had sold a total of 75,100 shares, including a block of 3,500 of Jaffee's shares sold in October 1963.

Rule 10b-6 provides, in pertinent part, that it is a manipulative or deceptive device for any person who is an underwriter in a particular distribution of securities, or one on whose behalf such a distribution is being made, or a broker-dealer or other person who has agreed to participate or is participating in such distribution, to bid for or purchase such securities until he has completed his participation in the distribution.

[*Purchases as Principal*]

During the relevant period, G Co., which engages mainly in trading securities for its own account, purchased as principal through Horn over 25,000 shares of registered Solitron stock from Lee for resale. With every such purchase of stock and until such shares were resold, G Co., which received copies of the Solitron prospectus from Lee and thus was aware that a distribution of registered Solitron stock was in progress, became a participant in the distribution and subject to the prohibitions in Rule 10b-6.[5] Nevertheless, while participating in that distribution, G Co., through Horn, not only continuously inserted bids in the quotation sheets published by the National Quotation Bureau, Inc., but also effected purchases for its own account of Solitron stock that was not a part of the offering. Horn had also received a copy of the Solitron prospectus from Lee. Thereafter, before making purchases of Solitron stock from that firm, he should have inquired into the status of the offering so as to determine whether to discontinue bids for the stock and purchases of stock not a part of the offering. Lee's president testified that he examined the sheets every day and knew that G Co., was entering bids as well as offers for Solitron stock throughout the relevant period. Yet Lee continued to sell registered Solitron stock to G Co., and therefore, contrary to the examiner's finding, knew or should have known that G Co., was participating in the distribution. By such sales Lee aided and abetted G Co.'s violations of Rule 10b-6.

Jaffee, although he was one of the selling stockholders under the registration statement, made purchases of Solitron stock for his own account during the relevant period, and admitted that prior to that period but during the course of the Solitron offering he had asked Horn to "go into" the sheets. Thereafter, Horn as indicated above entered bids for the stock.[6]

Jaffee and Lee state that the Solitron registration constituted a "shelf registration" or "delayed offering" and argue that such an offering does not constitute a distribution within the meaning of Rule 10b-6. Jaffee further contends that the one sale of only 3,500 shares of registered Solitron stock on his behalf during the relevant period was not a distribution. G Co. and Horn claim that they simply engaged in normal trading activities, and Jaffee, G Co., and Lee assert that the record shows none of the usual indicia of a manipulation nor any manipulative intent on their part.

[*No Merit*]

There is no merit in these contentions. An offering of stock pursuant to a registration statement by its very nature constitutes a distribution within the meaning

[5] Although G Co. does not meet the definition of "underwriter" in Rule 10b-6(c)(1)—which is narrower than that in Section 2(11) of the Securities Act, the prohibitions of the Rule are applicable to any "person who . . . is participating" in a particular distribution "directly or indirectly" (10b-6(a)(3)). A distribution of securities comprises "the entire process by which in the course of a public offering a block of securities is dispersed and ultimately comes to rest in the hands of the investing public." *Oklahoma-Texas Trust*, 2 S.E.C. 764, 769 (1937), *aff'd* 100 F. 2d 888 (C.A. 10, 1939). See also *Shearson, Hammill & Co.*, Securities Exchange Act Release No. 7743, p. 9 (November 12, 1965).

[6] The only evidence of Jaffee's arrangement with Horn is contained in a transcript of Jaffee's prior investigative testimony portions of which were received in evidence only against Jaffee and therefore cannot be used against Horn.

© 1970, Commerce Clearing House, Inc.

of Rule 10b-6.[7] For purposes of the Rule, such distribution must here be deemed to have commenced at least upon commencement of the offering by the exclusive agent following the effective date of the registration statement. Jaffee, having agreed to participate in such an offering, became a participant in the distribution irrespective of any sales of his own registered shares, and his participation continued for so long as any of such shares remained unsold or until they were withdrawn from registration. Otherwise, the Rule's prophylactic purpose could be circumvented since each selling stockholder in turn could refrain from selling his shares for a certain period while engaging in buying and bidding activities serving to raise the price of the stock, and thereby benefit the other selling stockholders as well as himself when sales were effected at the higher price. Similarly, the Rule could be circumvented by Lee were it permitted, merely if it refrained from making bids or purchases, to sell the stock to other broker-dealers engaged in such activities. Whatever the type of offering involved in this case may be called—a time-to-time offering, or a shelf registration or delayed offering—it is clear that Rule 10b-6 is applicable.[8] The fact that the shareholders could control the timing of their sales in no way obviated the need for the protections of the Rule or gave rise to any exemption from it. G Co., and Horn should have been aware that their purchases for resale of stock that they knew was part of a registered offering did not constitute normal trading activity. Persons, like G Co., engaging in market-making activities in a security which at the same time is being offered in a registered distribution must not participate in such distribution unless they have terminated their bidding and purchasing in the open market as provided in Rule 10b-6. Finally, Rule 10b-6 defines certain conduct as manipulative *per se;* no further showing of manipulative practices or manipulative intent is required in order to establish violations of the Rule.[9]

Lee asserts that it had the right to assume that G Co., was buying registered Solitron stock for investment purposes and thus not participating in a distribution. Jaffee, Lee, and G Co., argue that they did not employ the mails or interstate facilities required for finding violations by them during the relevant period, and Jaffee and Lee assert that any violations by them were not willful. We disagree. Lee had no basis for assuming that a dealer who was placing offers for Solitron stock in the sheets every day was buying the stock for investment. G Co.'s insertion of bids in the sheets, which are disseminated in interstate commerce, is a sufficient jurisdictional basis to support the findings against it and against Jaffee who arranged for such insertion.[10] Lee mailed confirmations of Solitron purchases and prospectuses to G Co., and in addition there were telephone conversations relating to Solitron between the two firms.[11] It is well established that a finding of willfulness under Section 15(b) of the Exchange Act does not require an intent to violate the law; it is sufficient that the person charged with the duty knows what he is doing.[12] Moreover, Jaffee and

[7] See Whitney, *Rule 10b-6: The Special Study's Rediscovered Rule*, 62 Mich. L. Rev. 537, 573 (1964): "There is no question that a 'distribution' [within the meaning of Rule 10b-6] is contemplated in an underwritten offering to the public of previously unregistered securities pursuant to registration under the 1933 Act . . .". The test used in *Bruns, Nordeman & Company* (40 S.E.C. 652, 660 (1961)) in finding there was a "distribution" under the Rule of securities which were neither registered nor subject to registration (i.e., the magnitude of the offering and selling effort), merely extended the application of that term. See Comment, *The SEC's Rule 10b-6: Preserving A Competitive Market During Distributions*, 1967 Duke L. J. 809, 820. In *J. H. Goddard & Co., Inc.*, Securities Exchange Act Release No. 7618, p. 4 (June 4, 1965), we found sales by an underwriter of control shares subject to registration under the Securities Act to be a Rule 10b-6 distribution without regard to the *Bruns, Nordeman* test, whereas we applied that test to sales of blocks of stock which were neither registered nor subject to registration.

[8] See *Hazel Bishop, Inc., supra*, 40 S.E.C. at 735-6; *Lum's, Inc.*, Securities Act Release No. 4950, pp. 7-8 (December 21, 1966); *Securities Act* Release No. 4935, pp. 5-6 (December 9, 1953).

[9] See *Lum's, Inc., supra*. Respondents' reliance upon cases involving manipulative practices in addition to those found herein is misplaced. The manipulation violations at issue in those cases were based on antifraud provisions including Rule 10b-5, or both Rules 10b-5 and 10b-6.

[10] See *F. S. Johns & Company, Inc.*, Securities Exchange Act Release No. 7972, p. 13, n. 16 (October 10, 1966), *aff'd sub nom. Dlugash v. S.E.C.*, 373 F. 2d 107 (C.A. 2, 1967) and *Winkler v. S.E.C.*, 377 F. 2d 517 (C.A. 2, 1967).

[11] See *Mozel v. Fields*, 386 F. 2d 718, 727-8 (C.A. 8, 1967), *cert. denied* 390 U. S. 951.

[12] *Gearhart & Otis, Inc. v. S.E.C.*, 348 F. 2d 798, 802-3 (C.A. D.C. 1965); *Tager v. S.E.C.*, 344 F. 2d 5, 8 (C.A. 2, 1965). See also *Dlugash v. S.E.C.*, 373 F. 2d 107, 109 (C.A. 2, 1967), which held that where the circumstances were such as to put respondents on notice that "something was wrong, . . . they were under a duty to investigate and their violation of that duty brings them within the term 'willful' in the Exchange Act."

Lee were on notice of the applicability of Rule 10b-6 as shown by their agreements with Solitron in which they undertook to abide by the provisions of that Rule.

We conclude that G. Co., which, as has been noted, knew that it was purchasing and selling shares that were part of a registered offering, willfully aided and abetted by Horn and Lee, and Jaffee willfully violated Section 10(b) of the Exchange Act and Rule 10b-6 thereunder.[12a]

With respect to J Co., it was not in existence during the relevant period and, as a basis for findings against it, the order for proceedings was amended to add charges of violations by its predecessor firm, Jaffee and Leverton ("J&L"). In view of our disposition of these proceedings with regard to J Co., as set forth below, we deem it unnecessary to determine on the record before us whether J&L, as a result of its transactions in registered Solitron stock, became a participant in the distribution and violated Rule 10b-6, and whether J Co., would be chargeable with any such violation.

As to Greene and Topol, there is no evidence that they were or should have been aware of the registered offering of Solitron stock. Accordingly, we find no violations of Rule 10b-6 by them, and they were not charged with a failure to supervise Horn with a view to preventing such violations.

Failure to Deliver Prospectuses

Section 5(b)(2) of the Securities Act of 1933 makes it unlawful to cause to be carried through the mails or in interstate commerce any security, with respect to which a registration statement has been filed, "for the purpose of sale or for delivery after sale" unless accompanied or preceded by a prospectus. We find that, during September and October 1963, G Co. and Horn willfully violated that Section.

The record shows that during that two-month period G Co. caused its clearing agent to deliver 6,100 shares of registered Solitron stock through the mails to 18 broker-dealers but sent no prospectus to them. Horn was the only trader dealing in the stock at G Co. at that time. Contrary to the examiner's finding, it was Horn's responsibility, under the firm's system then in effect, to make a notation on the order ticket when he sold registered stock which would alert the back office to send a prospectus in connection with delivery of the shares. No such notation was made on any of G Co.'s Solitron order tickets, nor does any appear on sale confirmations, as would have been the case if any prospectuses had been sent to customers who purchased registered Solitron stock. In fact, the back office at G Co. received no special instructions concerning transactions in Solitron.

Since there is no evidence that Greene or Topol knew or should have known of Horn's failure to carry out his responsibility to see that prospectuses were delivered, we find no violations by them of Section 5(b)(2), and they are not charged with any failure of supervision. Nor does the record support findings of violations of that Section by Jaffee. For the reason previously indicated, we do not reach the question of J&L's liability in this respect.

G Co. argues that it was not acting as an underwriter with respect to Solitron stock and therefore, under Section 4(1) of the Securities Act, the prospectus-delivery requirements were not applicable to it;[13] that the Davidson had the burden of proving that the broker-dealers to whom G Co. sold registered shares had not already obtained a prospectus from some other source; that, in fact, these broker-dealers had previously purchased stock from Lee which sent a prospectus to every purchaser and, in any event were sophisticated dealers who did not need the information in the pros-

[12a] We cannot agree with the suggestion in the dissent to this portion of our opinion that to hold G Co. in violation of Rule 10b-6 could result "in a form of discrimination" as between the market maker and the over-the-counter market and the specialist registered with an exchange. A specialist, no less than an over-the-counter market maker, is subject to the prohibitions of the Rule if he is a participant in a distribution other than one covered by a plan filed by the exchange as provided under Rule 10b-6(a)(10). It is not material to consider whether or not a question would arise in the situation posed by the dissent of a purchase by the specialist of a very small number of shares subject to registration. His obligation, as a specialist, is to maintain a "fair and orderly market" in the particular security, and dealings for his own account are restricted so far as practical to those reasonably necessary to permit him to maintain such market. (Section 11(b) of the Exchange Act; see *Re, Re & Sagarese*, 41 S.E.C. 230, 231 (1962)). A market maker such as G Co. is not under the same obligation to maintain a market, and, in any event, the number of shares purchased by G Co., as previously noted, was substantial.

[13] Section 4(1) provides that the registration and prospectus requirements of Section 5 shall not apply to transactions by any person other than an issuer, underwriter or dealer.

© 1970, Commerce Clearing House, Inc.

pectus; that a negative inference must be drawn from the staff's failure to call G Co.'s cashier instead of its assistant cashier as a witness because the latter "was not in a position to have knowledge of the facts at issue;" and that any violations by it were not willful.

[*Exemptions Inappropriate*]

We reject these contentions. It has been judicially established that the Section 4(1) exemption does "not in terms or by fair implication" protect those who, like G Co., "are engaged in steps necessary to the distribution of security issues."[16] G Co., as principal, purchased shares of registered Solitron stock from Lee and resold those shares to other broker-dealers. These purchases made G Co. a participant in the distribution and brought it within the definition of "underwriter" in Section 2(11) of the Securities Act.[17] G Co. does not fall within the exception from the definition of "underwriter" in Section 2(11) for persons whose interest is limited to receipt, from an underwriter or dealer, of usual and customary distributors' or sellers' commissions. It has not shown, in accordance with Rule 141 under the Securities Act, that its "commission" or margin of profit on resales was not in excess of the spread that is usual and customary in such transactions. Since G Co. was an "underwriter" within the meaning of Section 2(11), its transactions in Solitron securities were not exempted from Section 5 of the Act by Section 4(1), which is limited to a person other than an issuer, underwriter or dealer, or by Section 4(3), which is limited to a dealer "no longer acting as an underwriter."[18]

The record does not show that any of the broker-dealer customers who did not receive a prospectus from G Co. had previously purchased registered Solitron stock from Lee or received a prospectus from Lee or any other source. It was G Co.'s burden, not the staff's, to prove that a particular purchaser had already obtained a prospectus elsewhere.[19] The fact that the purchasers may have been "sophisticated" broker-dealers did not relieve G Co. of its statutory obligation.[20] While the then assistant cashier, who is presently the cashier of G Co., testified that he was not familiar at the time with "all aspects of the trading activity being conducted," he had been employed by G Co. in "different phases" of its back office work since 1955 and had served as its assistant cashier since about 1960. Under the circumstances, we consider that he was fully competent to testify with respect to the matters concerning which he was questioned, and, since G Co., was free to call its former cashier as a witness if it considered his testimony superior, there is no basis for assuming that the former cashier would have testified to any different effect. Moreover, G Co. concedes that the "system in effect" required that trading slips be marked "prospectus enclosed" by each trader "to assure that the back office would send out prospectuses." Finally, G Co., and Horn caused registered Solitron stock to be sent through the mails for delivery after sale without sending customers prospectuses, and accordingly, on the basis of our discussion of willfulness in the context of Rule 10b-6, their violations of Section 5(b)(2) of the Securities Act were willful.

Other Matters

Jaffee attacks various rulings of the examiner. During cross-examination of a staff investigator who had prepared various charts showing trading in Solitron stock,[21] the examiner denied Jaffee's request for production of reports of staff interviews with and statements obtained from customers of J&L whose names appeared on

[16] *S.E.C. v. Chinese Consolidated Benevolent Association*, 120 F. 2d 738, 741 (C.A. 2, 1941), *cert. denied* 314 U. S. 618. See *S.E.C. v. Guild Films Company, Inc.*, 279 F. 2d 485, 489 (C.A. 2, 1960); *Sutro Bros. & Co.*, 41 S.E.C. 470, 477-78 (1963). See also *S.E.C. v. Culpepper*, 270 F. 2d 241, 248-47 (C.A. 2, 1959), which held that a broker-dealer who purchased, for resale to the public, unregistered shares from other brokers who had acquired such shares from a control group of the issuer, was not entitled to a Section 4(1) exemption since he had "engaged in steps necessary to the consummation of the public distribution."

[17] *S.E.C. v. Culpepper*, *supra*, at p. 247.

[18] Even if we view G Co. as having acted solely as a dealer, the exemption provided in Section 4(3) would not be available for its transactions. The registered securities sold by Lee to G Co. were in the nature of "an unsold allotment to or subscription by [a] dealer as a participant in the distribution of such securities . . . by or through an underwriter" within the meaning of Section 4(3)(C).

[19] 1 *Loss, Securities Regulation* 250 (2d ed. 1961).

[20] *Cf. Pennaluna & Company, Inc.*, Securities Exchange Act Release No. 8083, p. 9 (April 27, 1967), and cases there cited.

[21] Jaffee, G Co. and Lee object to the admission of these charts into evidence, and Jaffee, to the admission of a notebook kept by Lee detailing its sales of Solitron stock. Since none of our findings is based on these documents, we deem it unnecessary to consider these objections.

such charts as purchasers of Solitron stock. Neither the Jencks Act[20] nor the case of *Brady v. Maryland*[21] cited by Jaffee entitled him to obtain the confidential investigative material sought. The Jencks Act, which in substance is incorporated into our Rules of Practice,[22] provides that prior statements of Government witnesses shall not be the subject of inspection until such witnesses have testified on direct examination, and is obviously inapplicable to Jaffee's request. The *Brady* case held that suppression by the prosecution of material evidence favorable to an accused who has requested it is a denial of due process. It does not authorize a "fishing expedition" into investigative material.[23] In any event, we have made no findings with respect to sales of Solitron stock by J&L.

There is similarly no basis for Jaffee's claim of prejudice resulting from his inability to inspect certain confidential Commission files relating to the Solitron registration statement. At the hearings, the attorney who prepared that statement was called as a witness by Lee and testified to various discussions with our staff concerning the mechanics of the offering. Apparently, in an effort to satisfy the examiner's doubts concerning this witness' credibility, Lee requested that the staff produce "anything" in the Commission's Solitron files "reflecting on these conversations that the witness has testified about." Not only did Jaffee fail to join in Lee's request, which the examiner denied, but he has made no showing of the relevance of the evidence sought nor of any adverse effect upon him resulting from its absence.

Public Interest

Jaffee, Horn, and Lee argue that the public interest does not require the imposition of any sanctions upon them, and G Co. contends that any sanction other than censure would be unwarranted.[24]

Jaffee asserts, among other things, that his record is otherwise good, that he cooperated with our staff, and that his violations, if any, were technical in nature. We do not consider that Jaffee's violations of Rule 10b-6 were merely technical. Bids and purchases in the course of a distribution at market price have a manipulative effect on such price to the detriment of investors. We conclude that under all the circumstances it is appropriate in the public interest to suspend Jaffee from association with a broker or dealer for 20 days.

Horn asserts that his only function was as a trade. However, Horn was responsible for all of the violations which occurred at G Co. In view of his violations of Rule 10b-6, as well as of Section 5(b)(2) of which he was exonerated by the examiner, we conclude that the public interest requires that he be suspended for 30 days.

G Co. no longer employs Horn, and its partners, with respect to whom we have found no violations, point to lengthy unblemished records in the securities business. Lee asserts, among other things, that no purchaser suffered a market loss. It points to the recent death of its president and 95% stockholder, who was in active control of its business during the relevant period, and states that it is presently in the process of liquidation.[25] Under these circumstances, we conclude that censure of the two firms will adequately serve the public interest.

With respect to J Co., a sanction may be imposed upon it pursuant to Section 15(b)(5) of the Exchange Act upon the basis of willful violations committed by an associated person, including a partner or controlling person, prior to becoming so associated if in the public interest.[26] The record shows that at the time these proceedings were instituted and during the hearings, Jaffee's partnership interest in J Co., which has two partners, exceeded 90%. The hearing examiner dismissed the proceedings against J Co. on the ground that the order for proceedings was not notice to that firm that Jaffee's association with it provided a basis for a sanction.

In our opinion, however, the order for proceedings constituted sufficient notice to J Co. that it would be subject to a sanction if findings of violations were made against Jaffee. J Co. was named a respondent and was served with a copy of that order. The

[20] 18 U.S.C. 3500 (1957).
[21] 373 U.S. 83 (1963).
[22] See Rule 11.1.
[23] See *Harris Clare & Co., Inc.*, Securities Exchange Act Release No. 8004, p. 4 (December 9, 1966).
[24] Since we have found no violations on the part of Greene or Topol, the proceedings will be dismissed as to them.
[25] Dissolution of a respondent broker-dealer firm is no bar to the imposition of a sanction in the public interest. See *W. T. Anderson Company, Inc.*, 39 S.E.C. 630, 633 (1960).
[26] See *Richard N. Cea*, Securities Exchange Act Release No. 8662, p. 15 (August 6, 1969), and cases there cited. *Cf. Securities National Corporation*, 35 S.E.C. 163 (1953).

© 1970, Commerce Clearing House, Inc.

order alleged violations of the securities acts by Jaffee, identified him as a partner of J Co., and recited that "in view of the allegations made . . ., the Commission deems it necessary that private proceedings be instituted to determine . . . what, if any, remedial action is appropriate in the public interest pursuant to Section 15(b) . . . of the Exchange Act." Accordingly, we reverse the examiner's order dismissing the proceedings against J Co.[27] And since Jaffee is the controlling partner of J Co., we conclude that the firm's broker-dealer registration should be suspended for 20 days, the same period as Jaffee's suspension.[28]

J Co., Jaffee, G Co., and Horn have filed motions requesting further oral argument before us and stays of any sanctions imposed pending determinating of petitions for review to be filed by them in the Court of Appeals.[29] The Division filed a memorandum in opposition. No basis for further oral argument has been shown, and that request is denied. With respect to the request for stays, the specified effective date of the sanctions in our order will provide movants with time to file petitions for review before the sanctions go into effect. The sanction with respect to any respondent who files such a petition prior to the effective date shall be stayed pending final determination of the petition.

An appropriate order will issue.

By the Commission (Chairman BUDGE and Commissioner OWENS), Commissioner SMITH concurring in part and dissenting in part, and Commissioners NEEDHAM and HERLONG not participating.

[*Concurring and Dissenting Opinion*]

Commissioner SMITH, concurring in part and dissenting in part:

I concur with the majority in all aspects of the case except its findings of violations of Rule 10b-6 by G Co., its trader Horn, and Lee. I do not believe the test used, that the registration of an offering *per se* makes that Rule applicable, comports with the intended coverage of the Rule, and, using a stricter test, I do not believe the evidence supports findings of violations. Consequently, I would reduce the sanction against Horn to censure and would dismiss as to Lee.

The majority reasons first that G Co. was an "underwriter" in a "distribution" within the meaning of those terms in Section 2(11) of the 1933 Act and thereby is required by Section 5 of that Act to deliver prospectuses. With that reasoning I agree. From that the majority deduces that a "particular distribution" was also occurring and G Co. was, if not an "underwriter," at least "participating" in that distribution within the meaning of those terms as used in Rule 10b-6 under the 1934 Act, thereby prohibiting any bids or purchases by G Co. in the course of market-making. While the symmetry is appealing, I do not think the result necessarily follows. I cannot agree with the majority's premise that a public offering of securities requiring registration under the 1933 Act "by its very nature" constitutes a distribution for purposes of Rule 10b-6 under the 1934 Act.[1] Nor can I agree with the asserted consequence, that a person who is a statutory underwriter for purposes of the 1933 Act is automatically a participant in a distribution subject to Rule 10b-6. The term "distribution" is defined in neither the 1933 Act nor the 1934 Act, and its meaning and applicability to particular persons in each context should be strictly derived from the differing purposes for which it is used.

The purpose of the 1933 Act is to provide adequate disclosure about the issuer and the offering to the ultimate purchaser, and so one participating in the distribu-

[27] See *Advanced Research Associates, Inc.*, 41 S.E.C. 579, 613, n. 77 (1963).

[28] The exceptions to the initial decision of the hearing examiner are overruled or sustained to the extent they are inconsistent or in accord with our decision.

[29] Creene and Topol also joined in the motions, but since the proceedings will be dismissed as to them, their requests are moot.

[1] The majority cites former Commissioner Whitney's excellent article for this proposition. Whitney, *Rule 10b-6: The Special Study's Rediscovered Rule*, 62 Mich. L. Rev. 567, 573 (1964). I do not read the article to say that. The sentence quoted by the majority appears to me to contemplate the usual "underwritten offering" through a syndicate of securities firms, at which the group of 10b-6, 10b-7 and 10b-8 rules simultaneously adopted in 1955 were mainly aimed. See Foshay, *Market Activities of Participants in Securities Distributions*, 45 Univ. of Va. L. Rev. 407 (1959). In his article Mr. Whitney said (footnote 3), "the prudent 'rule of thumb' assumes that a registered 1933 Act 'distribution' normally will be subject to Rule 10b-6." That phrasing is a long way from a *per se* application. Moreover, when he defines distribution for 10b-6 purposes, he does so (footnotes 31 and 37) in terms of the *Bruns, Nordeman* test I described below, and indicates (footnotes 3 and 26) that the term is used for different purposes in the two statutes so that interpretations of one do not necessarily control the other.

tion of the new issue is required to see to it that a prospectus reaches the ultimate purchaser. With that purpose in mind, it behooves us to bring within the distribution process someone purchasing for resale who is in a position to effectuate prospectus deliveries (such as a professional like G Co.) and who cannot avail himself of any of the specific statutory exemptions. This we did.

On the other hand, the purpose of Section 10(b) of the 1934 Act is to prevent manipulation in the trading markets. Here we are called on by Rule 10b-6 to keep someone who chooses to be on the sell side of the market out of the market on the buy side where the particular distribution by that person is of such a nature as to raise a sufficient temptation to manipulate (because the financial rewards are high enough) to cause a threat to the integrity of the market processes. Thus, selling shareholders—such as Jaffee—are prohibited by Rule 10b-6 from buying when they are selling or poised to sell, and Lee, the exclusive agent for the selling shareholders, is similarly prohibited. Jaffee, who purchased with shares unsold, violated 10b-6[2] and in my view Lee, who made no purchases, did not. G Co., a market-maker, and Horn, its trader, stand on a different footing.

It is not difficult to conceive that in certain situations where 1933 Act registration serves a purpose, to apply Rule 10b-6 would serve no purpose because the dangers of manipulation at which the Rule is aimed do not exist.[3] For example, if an individual acquires a small number of shares, say 200, directly from a listed issuer in an actively traded stock and promptly sells them on the floor of the exchange, it is clear he would be a statutory underwriter for purposes of Section 2(11) of the Securities Act of 1933, and Section 5 would require him to register those shares. However, there would be no warrant in applying the prohibitions of Rule 10b-6 to a specialist who purchases those shares in the course of his functioning as a specialist, even though he obviously purchases them for resale. Sales of these shares would be simply normal trading transactions to which, I submit, Rule 10b-6 is not intended to apply. The specialist would not be required to exert any special efforts to sell these shares, since the amount involved does not approach a quantity the market is unable to absorb through normal action and no counteravailing sales effort is therefore needed to stimulate demand. Rule 10b-6 has never been applied to this situation, probably because it is recognized that to require the specialist to give up the book and withdraw his bid until he sold out his position in the registered stock would unduly and unnecessarily disrupt the operation of the exchange market. Yet Rule 153 under the 1933 Act recognizes the applicability of the prospectus delivery requirement for such exchange transactions.

[*Market Maker's Withdrawal*]

Unnecessary disruption of trading markets is as undesirable over-the-counter as on the exchanges. Nevertheless, the majority here would *per se* require any market-maker who buys shares covered by a registration statement to withdraw from the sheets. Such an automatic application of 10b-6 to a market-maker who is independent of the seller can result in a form of discrimination between the over-the-counter and exchange markets. There has not been persuasive demonstration in this case that the market-maker participated in the kind of activity which would raise the spectre of manipulative dangers at which Rule 10b-6 is aimed.

The Commission has had occasion to determine the circumstances which constitute a distribution for purposes of 10b-6 in several prior cases. In *Gob Shops*[4] the Commission, while not finding a Rule 10b-6 violation, indicated that a distribution for 10b-6 purposes hinges on the presence of a major selling effort by the broker-dealer. Later, in *Bruns, Nordeman*,[5] a case based on the same facts as *Gob Shops*, the Commission found a Rule 10b-6 violation by the broker-dealer and enunciated the test which must be met to reach that conclusion:

[2] It is material to me in finding violation of Rule 10b-6 by Jaffee that he held unsold registered shares when he purchased in the market and had taken no steps to deregister or otherwise disassociate himself from the selling group.

[3] There are, of course, situations where the converse is true: distributions that do not require registration under the 1933 Act but should be subject to Rule 10b-6 or comparable antimanipulative requirements, *e.g.*, "unregistered secondaries" or sales of substantial blocks acquired privately and held for the requisite investment periods. See Whitney, *supra* note 1 at 579 and 581.

[4] 39 S. E. C. 92, 103 at fn. 25 (1959).

[5] 40 S. E. C. 652 (1961).

© 1970, Commerce Clearing House, Inc.

"Rule 10b-6 is applicable to all distributions whether or not subject to registration under the Securities Act and whether or not the conventional procedure of utilizing an underwriter or selling group is employed. The term 'distribution' as used in Rule 10b-6 is to be interpreted in the light of the rule's purposes as covering offerings of such a nature or magnitude as to require restrictions upon open market purchases by participants in order to prevent manipulative practices. For these purposes a distribution is to be distinguished from ordinary trading transactions and other normal conduct of a securities business upon the basis of the magnitude of the offering and particularly upon the basis of the selling efforts and selling methods utilized."[6]

In subsequent cases the Commission reaffirmed its position that a concerted selling effort of an unusually large amount of securities constitutes the hallmark of a distribution for 10b-6 purposes.[7] None of the cases cited by the majority, save possibly one, reflects a departure from the *Bruns, Nordeman* test.

In *Hazel Bishop*,[8] for instance, the Commission issued a stop order for false and misleading statements in a pending registration statement covering a large secondary distribution at the market. The Commission there warned that any broker or person "acting for" any selling stockholder would be subject to the provisions of Rule 10b-6. There is no indication in *Hazel Bishop* that mere awareness or knowledge of a 1933 Act distribution, without more, is sufficient to make a market-maker purchasing and selling that stock for his own account a participant violating Rule 10b-6. There is no proof in this case that Horn or G Co. was "acting for" Lee or any of the selling stockholders.

In *Lum's*[9] the issue before the Commission was whether or not a temporary suspension of the Regulation A exemption from 1933 Act registration should be made permanent. The Regulation A offering included shares which a broker-dealer (Aetna, which was also a market-maker in Lum's stock) had acquired privately and certain shares owned by two principal officers of the company. After it had sold all its shares as principal, Aetna reentered the sheets with bid and asked quotations, while selling stock for and purchasing from the two officers, first as agent and later as principal. Aetna distributed all the selling stockholders' shares; 82% of the total shares it purchased during the relevant period were from the selling stockholders. The Commission determined in that case, correctly I believe, that Aetna was participating in a distribution for or on behalf of the two officers and Rule 10b-6 was applicable to its market activities. In the instant case, however, there is insufficient proof that G Co. was intimately involved with the selling stockholders or their exclusive agent, or was in any way acting for them, or was behaving other than as an independent market-maker.

The decision of the Commission in *Goddard*[10] need not compel a different result. In that case the broker-dealer/market-maker dominated and controlled the market in the unregistered stock being distributed, and its market activities in that stock would not be found to be ordinary trading transactions. The Commission pinpointed two particular such distributions of control stock to which it said Rule 10b-6 was applicable, as well as two particular distributions of non-control stock specifically meeting the *Bruns, Nordeman* test. The cases relied upon[11] to support the statement in *Goddard* that public sales of control stock subject to 1933 Act registration fall within the meaning of the term "distribution" in Rule 10b-6, all involved aggressive sales effort, as in *Goddard*, to induce purchases of the respective securities. There is no evidence that G Co. engaged in that type of conduct in this case.[12]

[6] *Id.*, at 660.

[7] See *Sutro Bros. & Co.*, Securities Exchange Act Release No. 7053 (1963); *Batten & Co., Inc.*, Securities Exchange Act Release No. 7086 (1963); *A. T. Brod & Co.*, Securities Exchange Act Release No. 7139 (1963); *Woods & Company, Inc.*, Securities Exchange Act Release No. 7178 (1963).

[8] 40 S. E. C. 718, 736 (1961).

[9] Securities Act Release No. 4850 (1966).

[10] Securities Exchange Act Release No. 7618 (1965).

[11] Cases cited in note 7 *supra*.

[12] The majority also cited, mistakenly I believe, *Oklahoma-Texas Trust*, 2 S. E. C. 764 (1937), and *Shearson, Hammill & Co.*, Securities Exchange Act Release No. 7743 (1965), as authority for finding G Co. and Horn participants in a distribution for purposes of Rule 10b-6 (majority opinion at footnote 5). The portions of the decisions cited relate only to determinations that a 1933 Act public offering had not ceased, one for the purpose of deciding whether a stop order should issue, the other for the purpose of deciding whether the Regulation A $300,000 limitation had been exceeded.

(Continued on next page.)

[*Proof Reviewed*]

Having discussed policy and precedent, I turn to proof in this case. A review of G Co.'s trading activities over the whole of the revelant period, from June 1963 to March 1964, does not reveal anything unusual. It purchased a total of 25,610 shares from Lee, less than 24% of the total shares registered. Its purchases were from time to time and not in large units disproportionate to the units it sold in trading. Its total purchases from Lee amounted to only about 26% of its total purchases from all sources. G Co. was neither high nor even tied for high on over 65% of the days it submitted bids in the sheets. A total of 25 other firms were in the sheets, at least two or more than one-half the total trading days. G Co.'s largest long position was only 1,239 shares, while its largest short position totalled 6,632 shares. It engaged in no retail sales or in any retail sales effort, and there is no indication that its activities in the wholesale market were in any way out of the ordinary. Its trading mark-ups did not appear to be unreasonable and as the hearing examiner stated, "no pattern of manipulation by raising prices was found in the sales transactions."[13]

A closer examination of the record indicates that in one month, September 1963, G Co., purchased 20,160 shares from Lee, or 71% of its total purchases from Lee during the entire period. Those purchases represented about 48% of the shares sold by the selling stockholders during the entire period. In that month this represented 52% of G Co.'s total purchases from all broker-dealers. Of the 20,160 shares, 6,600 were purchased from Lee in three trades on September 12 and 9,500 were purchased in eight trades on September 18. G Co. was high bidder in the sheets on two days, by ⅛ on September 11 and by ¼ on September 18, and tied for high on ten days out of the total of 20 trading days that month. Another firm was high bidder for five days in the month, and on six of the ten days when G Co. was tied for high, there were as many as three or more firms tied. The high bids that month moved between 9⅜ and 13¾, beginning the month at 9⅜ and ending at 12½. There is no persuasive evidence on which to find that G Co. was even the principal market-maker that month or that it dominated the market in volume or price. G Co.'s sales about equalled its purchases in September and its inventory position remaind throughout relatively low.

Even though this activity in September 1963 indicates a number of the registered shares were being traded by G Co., I can find no basis for finding that the stock was being absorbed by anything other than normal market action or that G Co. was acting in any way other than as an independent market maker responding to supply and demand in an unmanipulated market.[14] Certainly there is no evidence that a sales effort was undertaken or participated in by G Co. to convey these shares to purchasers. Thus, on this record, I am unable to conclude that a sufficient showing has been made that G Co. and Horn engaged in the kind of activity which would support a finding they were participants in a distribution for purposes of Rule 10b-6. Since that proof is insufficient, I cannot find violations of Rule 10b-6 in this case by Lee.

[ORDER]

Private proceedings have been instituted pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 to determine what, if any, remedial action is appropriate with respect to the above-captioned respondents;

Hearings having been held after appropriate notice, the hearing examiner having filed an initial decision, the Commission having granted the petitions for review that were filed and ordered review of such decision with respect to all other issues which were before the examiner concerning all the respondents except Martin L. Levy;

Various respondents having filed motions requesting further oral argument and stays pending review in the Court of Appeals;

(Footnote 12 continued.) Application of Section 10(b) of the 1934 Act was not involved in any way in *Oklahoma-Texas*. It is true that in another portion of the *Shearson, Hammill* decision, a Rule 10b-6 violation was found. It was determined in that case, however, that partners and employees of the broker-dealer made extensive solicitations of subscribers for the issue and purchased and resold shares of the issue as individuals, all at the time the firm was entering bids in the sheets and was the principal market-maker.

[13] Initial Decision, at p. 22.

[14] As the majority points out, the only evidence in the case of a possible arrangement between Horn and Jaffee relating to trading in Solitron stock, was admitted only as against Jaffee, and cannot be used against Horn or G Co. The existence of a direct wire between G Co., and J Co., is not sufficiently probative.

© 1970, Commerce Clearing House, Inc.

Proposed Amendment to Exchange Act Rule 15b9-2

The Commission having this day issued its Findings and Opinion; on the basis of said Findings and Opinion.

IT IS ORDERED that the requests for further oral argument be, and they hereby are, denied.

IT IS FURTHER ORDERED that Greene & Company and M. L. Lee & Co., Inc. be, and they hereby are, censured; that the registration as a broker and dealer of Jaffee & Company be, and it hereby is, suspended for a period of 20 days; and that Wilton L. Jaffee, Jr. and Bernard Horn be, and they hereby are, suspended from being associated with a broker or dealer for periods of 20 days and 30 days, respectively. The sanctions shall become effective as of the opening of business on May 4, 1970. In the event that prior to that date a petition for review of this order is filed pursuant to Section 25(a) of the Securities Exchange Act of 1934 by Jaffee & Company, Wilton L. Jaffee, Jr., Greene & Company, or Bernard Horn, this order shall be stayed with respect to the petitioner pending final determination of the petition.

IT IS FURTHER ORDERED that these proceedings be, and they hereby are, dismissed with respect to Irving A. Greene, Robert Topol, and Martin L. Levy.

By the Commission.

[¶ 77,806] Proposed Amendment to Exchange Act Rule 15b9-2 to Set Annual Fees for Nonmember Broker-Dealers for Fiscal 1970.

Securities Exchange Act Release No. 8869. April 21, 1970. Release in full text.

Broker-Dealers—NASD Nonmembers—Annual Fees—Form SECO-4.—Form SECO-4 of Exchange Act Rule 15b9-2 is proposed to be amended to set fees for the fiscal year 1970 for registered broker-dealers who are not members of the National Association of Securities Dealers, Inc. The fees for 1970 are proposed to remain at a base fee of $100.00, a fee of $5.00 for each associated person, and a $30.00 fee for each office. However, the maximum amount payable by a firm in *annual* charges is proposed to be raised from $20,000.00 to $25,000.00. The foregoing amendment shall be effective June 1, 1970. However, interested persons are invited to submit comments upon the proposal by May 8, 1970, and if the proposal warrants amendment, the Commission will so amend it.

See ¶ 25,067, "Exchange Act—Over-the-Counter Markets" division, Volume 2.

The Commission has announced a proposal to amend Form SECO-4 of Rule 15b9-2 under the Securities Exchange Act of 1934 ("The Act") to set fees for the fiscal year 1970 for registered broker-dealers who are not members of the National Association of Securities Dealers, Inc. (nonmember broker-dealers).

Sections 15(b)(8) and 15(b)(9) under the Act authorize the Commission to collect such reasonable fees and charges as may be necessary to defray the costs of additional regulatory duties required to be performed with respect to nonmember broker-dealers. Pursuant to the above sections the Commission has adopted Rule 15b9-1 to establish initial fees and Rule 15b9-2 to provide for annual assessments. These rules prescribe the fee structure and the actual fees are set each year in the applicable forms required to be filed. This proposal deals with the amendment of Form SECO-4 under Rule 15b9-2, providing for *annual* fees. The forms requiring initial fees (Forms SECO-2 and SECO-5) would not be changed.[1]

Annual Fees—Rule 15b9-2

In general, Rule 15b9-2 now provides for annual assessment of non-member brokers or dealers which is comprised of (1) a base fee applicable to all such brokers or dealers; (2) a fee for each associated person engaged, directly or indirectly, in securities activities for or on behalf of the broker or dealer prior to May 15 during the fiscal year, at any time in which the firm was a nonmember broker or dealer; and (3) a fee for each office of the broker or dealer which was maintained prior to May 15 during the fiscal year, at any time in which the firm was a nonmember.

[1] The initial fees now in effect which would remain unchanged are as follows: $150 fee required to accompany Form SECO-5 which is filed in behalf of the broker-dealer; $25 fee required by Form SECO-2 which is filed for each associated person of the broker-dealer. Unlike the annual assessments, there is no upper limit on the total amount of initial fees payable.

Act—Forms" division, Volume 3; ¶ 27,016 and 33,731, "Exchange Act—Forms" division, Volume 3; ¶ 6048A and 7411, "Securities Act—Forms" division, Volume 1; ¶ 51,107, 51,107A and B, and 51,961, 51,981, 51,985, "Investment Companies—Forms" division, Volume 4; ¶ 43,012 and 43,121, "Trust Indentures—Forms" division, Volume 4.

The Commission today announced that in light of Section 7 of the Privacy Act of 1974 (Pub. L. 93-579), it will no longer deem as mandatory the disclosure of social security account numbers on certain forms which collect information from or about individuals. Although the disclosure of social security account numbers may be of assistance to the Commission in identifying persons and in promptly processing such forms, the Commission believes that disclosure of such numbers should be voluntary, notwithstanding that, under Section 7(a)(2)(B) of the Privacy Act, disclosure of social security account numbers in many of the forms utilized by the Commission could still be required.

In order to avoid the high costs that would be involved in revising its current forms to provide that the disclosure of social security account numbers is voluntary, the Commission has prepared a special notice that will be furnished to all persons who request copies of the forms from the Commission indicating that disclosure of social security account numbers is voluntary. In addition to this information, the notices will set forth the information required by Section 7 of the Act, including the authority pursuant to which the information is being solicited and what principal uses will be made of the information.

As existing supplies of the forms are exhausted, the Commission may revise such forms or the instructions thereto as appropriate. Meanwhile, applicants and registrants who have on hand a supply of the affected forms or who make their own copies of Commission forms should keep in mind that they are no longer required to report individuals' social security account numbers.

[Form ADV is at ¶ 57,101; Form BDW is at ¶ 32,801; Form 3 is at ¶ 33,711; Form 4 is at ¶ 33,731; Form 144 is at ¶ 7411; Form N-1R is at ¶ 51,961; Form T-2 is at 43,121. CCH.]

By the Commission.

[¶ 80,327] Collins Securities Corporation; Timothy Collins; Vern D. Kornelsen

Exchange Act Release No. 11766. Investment Advisers Act Release No. 484. Administrative Proceeding File No. 3-2572. October 23, 1975. Release in full text.

Review of Initial Decision—Broker-Dealer's Antifraud Violations—Inflation of Market Price.—A broker-dealer and its president committed antifraud violations in manipulating the market of a security by artificially raising its "bid and asked" price in the "pink sheets" in an effort to boost its price over the warrant exercise price, inducing warrant holders to exercise their options. The registrant broker-dealer knew or should have known that the issuer's market was extremely thin and illiquid, and even relatively modest purchases would have an undue impact upon the price of the issue. Registrant had purchased some 75,000 shares on the open market and had sold them four days subsequent to the expiration of the option date. The broker dealer, in doing this, sold some 35,000 shares of the inflated security to customers as to whom it was admittedly in a fiduciary relationship.

See ¶ 22,721 and 22,725, "Exchange Act—Manipulations" division, Volume 2.

Exchange Act—Participating in a Distribution—Rationale.—Rule 10b-6, designed to prevent manipulation in the markets, precludes a person from buying stock in the market when he is at the same time participating in an offering of securities which is of such a nature as to give rise to a temptation on the part of that person to purchase for manipulative purposes. The term distribution, therefore, in the Exchange Act context should be interpreted to identify situations where the temptation to manipulate would be present. Here, the respondents participated in a distribution of the issuer's shares, and while participating in that distribution, placed bids and purchases of the issue in question, in contravention of Rule 10b-6.

See ¶ 22,726, "Exchange Act—Manipulations" division, Volume 2.

 © 1975, Commerce Clearing House, Inc.

Regulation T Violations—President's Duty.—The president of a broker-dealer firm has the responsibility to comply with all applicable regulatory requirements, and he retains that responsibility unless and until he reasonably delegates a particular function to another member of the firm. Here, there was not reasonable delegation, so Regulation T violations are properly attributable to registrant's president.

See ¶ 22,201, "Exchange Act—Margin; Borrowing Restrictions" division, Volume 2.

Recordkeeping Violations.—Though warrants in question were non-assignable on their face, the restriction became unnecessary in light of a registration subsequently filed. The method of treating this situation on the books would not matter to anyone. Consequently, the recording of stock purchases as purchases from warrant holders, rather than as purchases by registrant as assignee of the warrants, was of no moment.

See ¶ 26,151, "Exchange Act—Insiders; Liabilities" division, Volume 3.

Recordkeeping Violations—Existence of Records Elsewhere.—The fact that data required in the position record might have been derived from other sources does not satisfy the requirements of Rule 17a-3(a)(5). Therefore, respondents were rightfully found to have violated the Rule.

See ¶ 26,154, "Exchange Act—Insiders; Liabilities" division, Volume 3.

Securities Act—"Pink Sheets"—Prospectus Status.—Although the broad language of Section 2(10) of the Securities Act would support a finding that the "pink sheets" are prospectuses, such a reading would ignore history and statutory purpose of the Act; namely, to insure that buyers of registered securities get the prospectus, and to insure that such prospectus precedes any other selling information. To call "pink sheets" prospectuses would only marginally help investors and would hinder the marketing of securities.

See ¶ 1451, "Securities Act—Definitions" division, Volume 1.

Administrative Proceeding—Standard of Proof.—The standard of proof in remedial broker dealer proceedings is one of a preponderance of the evidence.

See ¶ 66,167, "Rules of Practice" division, Volume 4.

Arthur F. Mathews, Peter D. Bewley, for Collins Securities Corp. and Timothy Collins.

Vern D. Kornelsen, *pro se.*

Joseph F. Krys, Matthew J. Zale and William J. Klein, SEC Denver Regional Office, for the Division of Enforcement.

Grounds for Remedial Action

Manipulation of Market

Fraud in Sale of Securities

Bids for and Purchases of Stock During Distribution

Improper Extension of Credit

Failure to Comply with Recordkeeping and Reporting Requirements

Where registered broker-dealer and investment adviser, and its president, artificially inflated the market price of a security in order to induce warrant holders to exercise and, to the extent they did not, exercised for them and sold the stock acquired at an inflated price; bid for and purchased the security during the firm's distribution thereof; improperly extended credit to customers; and failed to comply with recordkeeping and reporting requirements, *held,* public interest requires revocation of firm's registrations, its expulsion from registered securities association and bar of president from association with any broker-dealer.

Meaning of "Distribution" for Purposes of Rule 10b-6

Registered offering of securities is not automatically a distribution for purposes of Rule 10b-6. To the extent that *Jaffe & Co.,* 44 S. E. C. 285 (1970), is to the contrary, it is *overruled.*

Quotations Not "Prospectuses"

Offers in a quotation medium are not "prospectuses" for Securities Act purposes. To hold otherwise would ignore history, go beyond and do nothing to serve the statutory purpose, and create unnecessary complications in the trading markets.

Responsibility of President

President of a broker-dealer firm retains responsibility for compliance with all applicable requirements unless and until he

reasonably delegates a particuluar function to another person in the firm, and neither knows nor has reason to know that such person is not properly performing his duties.

Collins Securities Corporation ("registrant"), a registered broker-dealer and investment adviser, Timothy Collins, its president, and Vern D. Kornelsen, a former firm employee, appeal from the findings made and the sanctions imposed by an administrative law judge.[1] The major issue before us is whether, as found by the hearing officer, respondents manipulated the market for and fraudulently sold common stock of Big Horn National Life Insurance Company during the period from about June 25 to July 25, 1968. To place that month's events in proper perspective, we look at them in their historical context.

Background

In 1968, registrant, with headquarters in Denver and branch offices in New York and Los Angeles, had more than 50 employees and was divided into four main departments. One of them, which employed Kornelsen, furnished financial counseling and investment banking services to regional companies. Those services includued the negotiation of acquisitions and mergers, the underwriting of new stock issues, and private placements. Another department managed the accounts of individuals who gave registrant the authority to do so on a discretionary or "quasi-discretionary" basis. A third department researched and sold various securities to institutional clients, while the fourth, the over-the-counter trading department, made markets in about 40 stocks. The firm also had a few fee-paying investment advisory clients, and Big Horn was one of that group.

Big Horn, a small Wyoming life insurance company, began operations in May of 1963. Some three years later, in the fall of 1966, Collins met Robert E. Cole, who had recently become Big Horn's president. A close relationship then developed between the two.

In early 1967, registrant, with the approval of Big Horn's board of directors, became investment adviser for Big Horn's common stock portfolio. And it also got most of Big Horn's brokerage business. Collins considered Big Horn "an important stepping stone for . . . entry into the investment advisory area and into the general area of dealing with financial institutions." He told Cole that registrant and Big Horn were both small companies that could help each other grow, and that, if he could do a good job for Big Horn, he could use it as a "bellwether" to acquire other advisory accounts.

At that time, Big Horn was sorely in need of additional funds. The company had operated at a loss since its inception, and Cole remarked that its need for additional capital was apparent "from the minute I walked in the door." During 1966 and 1967, Collins, who considered himself an expert in analyzing life insurance stocks and was registrant's primary insurance industry specialist, had repeated discussions with Cole and Van Irvine, chairman of Big Horn's board of directors, about the company's capital requirements. All of the various possibilities for additional financing were explored, including new stock issues, private placements, and debt offerings, as well as possible acquisitions and mergers. One of the topics discussed, which figures importantly in this case, was the possibility of Big Horn obtaining more than $500,000 in additional funds through the exercise by warrant holders of outstanding stock purchase warrants which the company had issued shortly after its formation.

At the time of Collins' discussions with Cole and Irvine, there were about 134,000 warrants outstanding, exercisable at $5.00 per shares, which were due to expire on July 25, 1968. Their utility as a vehicle for raising additional capital, however, was limited by the various restrictions with which they were hedged. Not only were the warrants non-transferable and exercisable only if the holder were a bona fide resident of Wyoming, but warrant holders agreed to refrain from acquiring the underlying shares with a view to distributing them to nonresidents of Wyoming.[2] To overcome the

[1] The hearing officer concluded that registrant's registrations should be revoked and registrant expelled from membership in the National Association of Securities Dealers, Inc. ("NASD"). He also determined that Collins and Kornelsen should be barred from association with any broker or dealer with the proviso that Kornelsen, after 3 months, might become so associated in a non-supervisory capacity, upon a showing to the Commission's staff that he would be adequately supervised. The parties filed briefs with us, and we heard oral argument. Our findings are based on an independent review of the record.

[2] These restrictions were obviously prompted by a Securities Act problem. The issuance of immediately exercisable warrants to the public

(continued on next page)

© 1975, Commerce Clearing House, Inc.

effect of these restrictions, Big Horn took steps to make it possible for those exercising the warrants to redistribute the underlying shares throughout the United States. A registration statement covering the shares was filed as early as November 21, 1966, twenty months before the warrants were due to expire. But there was one difficulty that was not so easy to overcome. The prospectus portion of the Big Horn registration statement, which became effective on March 20, 1967, noted that the range of quotations for Big Horn stock on March 17 was only 4 bid, 4¾ asked. And it stated what was only too obvious to all: "The warrants are not likely to be exercised so long as the market price . . . of the Company's common stock is less than the exercise price."

During the 1966-67 period, the market for Big Horn stock was extremely thin and illiquid. Only a few broker-dealer firms were entering quotations for the stock in the "pink sheets" published by the National Quotation Bureau, Inc., and they had no real interest in making an active trading market. Cole made repeated efforts to improve the market for Big Horn and enlisted Collins' aid in an unsuccessful attempt to interest additional firms in entering quotations. However, Collins himself resisted persistent efforts by Cole and Irvine to have registrant make a market in Big Horn and take a position in the stock. He was not interested in paying money to enter quotations for a stock "that never trade[d]," and did not consider a small insurance company like Big Horn an attractive investment. After repeated requests, registrant did begin making a market in Big Horn in March 1967 but dropped out of the sheets after about a month because of the lack of activity.

In early 1968, it became apparent that Big Horn's situation was becoming desperate. The company had been forecasting that it would break even or make a small profit in 1967. Instead, when year-end results were reported, it was learned that Big Horn had suffered an additional loss of $67,000. At that point, the company had accumulated an earned surplus deficit of over $1,000,000. The book value of its shares had dropped from $3.27 in 1962 to $1.37. And, even worse, its continued ability to write new insurance was threatened. Wyoming law required life insurance companies to have a minimum surplus of $100,000 in order to continue in business. At the end of 1967, Big Horn's total surplus was only $124,531.

Big Horn began casting about frantically for ways to raise additional capital. Cole renewed his efforts to get Collins to take a position in Big Horn stock and again discussed with him the possibility of a private placement. Cole also searched for avenues by which Big Horn could realize funds from the stock underlying its outstanding warrants, a task rendered more difficult by the fact that the market price for Big Horn had dropped still further below the warrants' $5 exercise price. He proposed that registrant, alone or together with other firms (undertake a "standby underwriting" in which the underwriters would agree to purchase the shares underlying warrants that holders did not exercise.

Collins showed a marked lack of enthusiasm for Cole's various suggestions. Instead, he put forward a proposal that he had previously suggested, namely that Big Horn transform itself into a holding company. Collins pointed out that a holding company structure would allow Big Horn to escape restrictive state insurance regulations and enable it to diversify by acquiring other companies. And he considered that the adoption of such a structure would have a favorable market impact on Big Horn stock in view of the "market fever" at that time for conglomerates. More important to the issues before us was Collins' belief that the mere fact that Big Horn was considering the formation of a holding company "could make everybody exercise [their] warrants." As his former counsel testified, "Tim Collins . . . prided himself [on being] financial adviser to Big Horn. He thought it was part of his job to help them in all . . . areas, including figuring out ways of getting the warrants . . . exercised."

Early in 1968, Collins met with Cole, Irvine and other directors of Big Horn, and the concept of a holding company was seriously discussed. After the meeting, Collins assigned Kornelsen to work with Cole on

(Footnote 2 continued.)
constitutes a public offering of the underlying securities for purposes of the Securities Act, as is made quite clear by Section 2(3) of that Act. Since that stock was not registered in 1963, the restrictions seems to have been imposed in an effort to qualify the continuing offering of the underlying stock for the so-called "intrastate" exemption provided for in Section 3(a)(11) of the Act. After the stock was registered in 1967, these restrictions no longer served any purpose.

plans to make that concept a reality. On February 7, Kornelsen sent Irvine and Cole a letter recommending a "plan of action" which suggested that the holding company be created as soon as possible. Although action by Big Horn's board was unnecessary for the first step of incorporating the new company, Kornelsen recommended that the board adopt an endorsing resolution since it could be "a significant public relations opportunity." In addition, the possibility of future finder's fees for registrant was not overlooked. Kornelsen's letter stated: "As soon as your structuring has been completed, we will be prepared to go into specific acquisition opportunities with you."

Thereafter, Kornelsen and Cole developed a "master plan" for the new holding company, to be called Western Resources Corporation, under which Western would make an exchange offer to Big Horn stockholders and acquire Big Horn as a subsidiary. The plan called for approval by Big Horn's board of directors on June 22, 1968, just one month before the warrants were due to expire. For its efforts in planning the holding company, as well as the nominal duties it would have in acting as "exchange agent" for the proposed exchange offer,[3] it was determined that registrant would receive compensation in the amount of 20,000 shares of Western stock. According to plan, the Big Horn board formally adopted the holding company proposal on June 22. Irvine testified, "I suspect we desired to announce it, hoping it would stimulate warrant exercisings."

Another plan was put into effect "to stimulate warrant exercisings." Security Brokerage Corporation ("SBC") had been the underwriter of Big Horn's initial stock offering. As part of its underwriting compensation, it had received 51,000 warrants plus the right to obtain 15% of all proceeds from the exercise of outstanding warrants. At the time with which we are concerned, SBC, whose stockholders were practically identical with the directors of Big Horn, had 33,556 warrants left. If all of the outstanding warrants were exercised, it (and thus the Big Horn directors) stood to gain about $75,000 from the exercise of warrants by other persons and a $25,000 discount on the exercise of its own. In February 1968, at the request of the Big Horn board, counsel for the company prepared a memorandum outlining various alternatives available to SBC with respect to its warrants. The memorandum concluded:

> "It is obvious that any possible benefits in the line of stimulating warrant conversion would be lost if the warrants of Security Brokerage are not exercised or irrevocably committed sufficiently in advance of their expiration to have an effect upon the holders of other warrants which expire at the same time."

Arrangements were accordingly made for SBC's warrants to be exercised in time and, as described below, for appropriate publicity of that fact to be given to other warrant holders. The stage was thus set for the events of late June to July 25, 1968.

Manipulation and Fraud

The administrative law judge found that, during the period from about June 25 to July 25, 1968, registrant and Collins manipulated the market for Big Horn stock by artificially raising its price through the insertion of quotations in the "pink sheets" published by the National Quotation Bureau. Respondents' immediate goal was to boost the price of Big Horn to a level at which warrant holders would be moved to exercise. To the extent that they did not, registrant could exercise for them without substantial financial risk, selling the stock it acquired at a profit based on the artificial market price it had managed to create.

Respondent's purpose was to gain the advantages that would accrue from a large infusion of desperately needed capital into Big Horn. If Big Horn were revitalized, the 20,000 shares registrant was to receive for its holding company efforts would acquire real value. Substantial finder's fees could be earned by registrant from the acquisitions on which the new holding company would be enabled to embark. Additional funds would be available for registrant to invest as manager of Big Horn's portfolio, and additional commissions could be earned on portfolio executions. The good relationship between registrant and Big Horn and its directors would be enhanced. And registrant could acquire other advisory and financial planning clients by pointing to what it had done for Big Horn.

Our review of the record convinces us that the hearing officer's conclusions were fully warranted. Respondents maintain that

[3] All that registrant had to do in connection with the exchange offer was solicit acceptances by mail from Big Horn shareholders residing in states in which registrant was a registered securities dealer.

© 1975, Commerce Clearing House, Inc.

registrant merely sought to invest in Big Horn stock. We find this contention wholly unfounded. Our reasons for rejecting it are stated below.

In late June 1968, Collins told Donn Douglass, registrant's vice-president in charge of trading, to begin entering quotations for Big Horn in the pink sheets. Douglass objected to trading Big Horn and "didn't want to own any of the stock," but Collins overrode his objections. Collins said that he had told Cole that registrant would make a market in Big Horn, and that he (Collins) was "anxious to buy some stock" and wanted to bid higher than other brokers in the sheets. Having checked the sheets which showed bids of 3 and 3½ and no offers, Douglass suggested an initial bid of 3¾. Collins, however, told him to enter a bid of 4 which "might create more activity at [an earlier date.]" Collins also directed Douglass to make a two-sided market in Big Horn, i.e., to enter asked as well as bid quotations, but did not tell Douglass why. Since the indications were that very little stock was available, it was decided that initially registrant would only enter bids. Its initial bid of 4 appeared on June 27. After registrant had been in the sheets for a few days and been unable to acquire any Big Horn stock, Collins called Douglass into his office. Showing impatience, he told Douglass to be "more aggressive" in acquiring stock, and to bid higher if necessary. Douglass complied. The following table shows the Big Horn quotations entered by Douglass and others from June 17 through July 25, the date the warrants were due to expire.

	V. F. Naddeo & Co. New York		*Birkenmayer & Co., Inc. Denver*		*Supplee-Mosley, Inc. Philadelphia*		*Registrant*	
	Bid	*Asked*	*Bid*	*Asked*	*Bid*	*Asked*	*Bid*	*Asked*
June 17	3		3	4	3½			
June 18	3				3½			
June 19	Market closed							
June 20	3		3		3½			
June 21	3		3		3½			
June 24	3		3		3½			
June 25	3		3		3½			
June 26	Market closed							
June 27	3		3		3½		4	
June 28	3		3		3½		4	
July 1	3		3		3½		4	
July 2	3		3		3½		4	
July 3	3		3		3½		4¼	5¼
July 4	Market closed							
July 5	Market closed							
July 8	3		3		3½		5¼	
July 9	3		3		3½		4¼	5½
July 10	Market closed							
July 11	3		3		3½		4½	5½
July 12	3		3		3½		4½	5½
July 15	3		3		3½		4¼	5¼
July 16	3½		3		3½		4¼	5¼
July 17	Market closed							
July 18	3½		3½		3½		4½	5½
July 19	3½		3½		3½		4¼	5¼
July 22	3½		3½		3½		4¼	5¼
July 23	3½		3½				4½	5
July 24	Market closed							
July 25	3½		3½				5¼	6¼

From the beginning of 1968 until registrant's entry into the sheets on June 27, no bid for Big Horn had exceeded 3½ and no offer had topped 4. Moreover, the market for Big Horn was practically moribund. As can be seen from the table, only two brokers, Birkenmayer and Supplee-Mosley (Naddeo was entering bids as correspondent for Birkenmayer) were entering quotations for Big Horn, but they had no real interest in the stock. In fact, Supplee-Mosley, which dropped out of the sheets altogether after

July 22, had continued to quote Big Horn only as a "personal favor" to Cole who had made a special trip to Philadelphia that spring to encourage the firm to continue its quotations. Birkenmayer's trader testified that the market for Big Horn was "very very thin . . . [and] very inactive," that he was entering bids for Big Horn because he was short some stock and "probably being pressed for delivery," and that his attitude was "for the stock to go away and leave me alone until it became active."

Efforts were made apart from registrant's entry to bolster the sagging market for Big Horn. Early in July, Cole telephoned Douglass to check on whether registrant was in fact making a market for Big Horn. He also requested Douglass' assistance in persuading Supplee-Mosley's trader to remain in the sheets, and said he would appreciate it if Douglass could interest anyone else in entering quotations. Douglass checked with Collins who not only told him to call Supplee-Mosley but directed him to contact another broker in Denver to see "if you can get him to trade Big Horn." Douglass complied but his efforts in both instances were unavailing.

As Collins was well aware, the market for Big Horn was so extraordinarily thin at that time that the acquisition of even a small number of shares was bound to increase the market price. Cole testified that, during that period, "you couldn't buy [a large block of Big Horn] on the open market without driving [the] price way out of sight," and Douglass that, at least until July 18, he felt that a thousand-share buy order would probably move the stock up a minimum of a half point and possibly a point, and a 5000-share order, in the area of 2 to 3 points. Having directed Douglass to make a two-sided market starting with a bid of 4, and having then ordered him to be "more aggressive," Collins could sit back and confidently await further developments. All that was necessary was to get offers above 5 in the sheets.

After registrant and Collins had arranged for offers to be placed in the sheets at the desired levels, Big Horn gave their efforts appropriate publicity. On July 12, copies of the updated prospectus covering the underlying shares were sent to all warrant holders. The accompanying letter stated as follows:

> "As set out in your warrants, the exercise price is $5.00 per share. You may obtain a current quote on the stock by asking any broker or checking the weekly over-the-counter listing in the Wall Street Journal or other major financial publications. By way of explanation of the bid and ask figures, the bid figure indicates the price at which a broker-dealer would buy shares and the ask price indicates the price at which a broker-dealer would sell the shares on the open market. *The warrants expire on July 25, 1968.*" (Emphasis in original.)

At about the same time as he directed Douglass to begin entering quotations for Big Horn in the pink sheets, Collins assigned another task to Kornelsen. He told Kornelsen that he had decided to buy 10,000-20,000 shares of Big Horn and, because it would not be practical to acquire a position of that size in the open market since it would run up the price, he would like Kornelsen to work out a plan to purchase some of the stock underlying the warrants.[4] Kornelsen testified, however, that Collins didn't indicate he would be greatly concerned if he failed to acquire the shares. In fact, Kornelsen's understanding was that Collins' intent to purchase was to be kept quiet because if known it "would depress the warrant holders' desire to purchase on their own." Collins exhibited a similar lack of enthusiasm for acquiring shares to Cole. Although he finally acceded to Cole's request that he purchase some of the warrant shares, he refused to tell Cole how many shares he would buy. And he exhorted Cole "to get as many of the warrants holders to exercise as possible."

Kornelsen and Cole, with the assistance of counsel, quickly worked out the mechanics which would enable registrant to acquire warrant shares in a way they considered would avoid the problem of the warrants' non-transferability. But before registrant purchased any shares, a last ditch effort was made to get warrant holders to exercise on their own. As noted above, copies of an updated prospectus were sent to warrant holders on July 12 with an accompanying letter telling them how to obtain a quote

[4] There is some disagreement in the record as to when this conversation took place. Collins testified that he thought it had occurred in May or June, and that, at the time he directed Douglass to go into the sheets, the mechanics for registrant's purchase of some of the warrant shares were already being worked out. Kornelsen placed the conversation in late June or early July. In any event, the hearing officer found that Kornelsen was assigned this task in May or June, and respondents did not except to that finding.

© 1975, Commerce Clearing House, Inc.

on Big Horn stock. Attached to each prospectus was a sticker calling the recipient's attention to the fact that Big Horn's board had recently determined to form a holding company that would acquire Big Horn and stating, "Certain of the directors who have committed themselves to exercise warrants aggregating 33,556 shares stated that their main reason for doing so was the Board's decision to initiate the formation of a holding company."[5] A second notice was sent to warant holders on July 19 reminding them of the expiration date and urging immediate action.

Around July 15, Big Horn began a telephone canvass of its warrant holders. They were asked if they intended to exercise their warrants and, if not, whether they objected to having a third party do so. If the warrant holder was amenable to a third party exercise, Kornelsen was notified and registrant's check for the full exercise price was sent to the warrant holder payable jointly to him and to Big Horn. The check was accompanied by a form of assignment transferring to registrant the shares underlying the holder's warrants. On receiving the endorsed check and executed assignment form, Big Horn had the transfer agent go through the motions of issuing shares to the warrant holder. Then the certificate was immediately cancelled and a new certificate issued in registant's name. Registrant then sent the warrant holder a confirmation of its "purchase" from him. These mechanics were designed to maintain the fiction that the warrant holders were exercising their non-transferable warrants, and then selling the underlying shares to registrant.

Registrant began buying the Big Horn stock underlying the warrants on July 18. On the 19th, a Friday, Kornelsen telephoned Collins in New York and reported that in just one day registrant had purchased about 12,000 shares, and that more shares were available. He asked Collins for further instructions. Collins was shocked. He had hoped that the warrant holders "had been watching the newspapers or . . . been reading their stickers or something," and "really felt that [they] would exercise." After thinking it over, he determined to go ahead with registrant's purchases. But on Monday, July 22, he initiated a major sales effort to rid registrant of all the warant stock it might acquire. He telephoned Garry Smith, who handled the firm's "managed accounts,"[6] and told him that Big Horn stock was available, that "it should be used in the managed accounts," and to spread the word around the Denver office that "we had some stock and . . . could sell it." The same message was conveyed to all of registrant's departments, and Collins himself participated in the sales effort. Collins testified, "We felt that if it was good enough for us to acquire, it was good enough for [clients] to acquire."

But, in fact, Collins did not believe that Big Horn stock was good enough for registrant to acquire for any longer than it took to resell the stock to someone else. He kept himself informed of the amounts of Big Horn stock being sold, but issued no instructions that any of it be retained for registrant. Delbert Hartley, registrant's executive vice-president and second-in-command of the firm, testified that Collins had no intention of taking an investment position in Big Horn at that time. He quoted Collins as saying:

> "My God, I just couldn't believe that much stock (75,694 shares) would come in off our offer. I felt maybe we would have ten or fifteen thousand shares, and I already had [a buyer] set up to take that much."

As noted, registrant purchased a total of 75,694 shares of warrant stock at $5 per share. From July 22 through July 25, it resold 73,460 of those shares at a price of 5⅛, including 35,500 shares to institutional clients, and 19,700 shares to its managed account customers as to whom it was admittedly in a fiduciary relationship. Through July 25, registrant's trading activities in Big Horn resulted in purchases of 8,770 shares and sales of 7,120 shares. By July 29, its total inventory of Big Horn stock was a mere 1,877 shares.

At the Big Horn board meeting of July 27, Cole reported that 88,229 warants, plus those of SBC, had been exercised resulting in the addition of $395,801 to Big Horn's surplus and $121,785 to capital. The board unanimously commended Cole for his excellent job in causing so many warrants to

[5] The warrants referred to were those held by SBC. Of the nine or so Big Horn directors who owned warrants individually, only one chose to exercise some of them.

[6] Smith, a respondent in these proceedings, did not appeal from the hearing officer's order barring him from association with any broker or dealer. The order therefore become final. Securities Exchange Act Release No. 10423 (October 9, 1973), 2 SEC Docket 535.

be exercised which "was not only timely but . . . of tremendous importance to the company and its future plans."

We think it clear that, during the period from June 27 through July 25, 1968, registrant and Collins manipulated the market for Big Horn, and sold warrant stock to customers without disclosing that its price had been artificially inflated. In doing so, they willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder.

The hearing officer found that Kornelsen aided and abetted these violations. We disagree. While it is true that Kornelsen played an important role in registrant's acquisition of warrant shares, the legality of that acquisition is not at issue here. And we find nothing in the record to show that Kornelsen was either a party to or aware of the manipulative scheme carried out by Collins. Accordingly, we make no findings against Kornelsen in connection with the foregoing violations.[7]

Registrant and Collins concede that registrant's actions caused Big Horn's market price to rise. But, as noted earlier, they insist that they placed quotations for Big Horn in the sheets merely to further their legitimate objective of acquiring an investment position for registrant of 10,000 to 20,000 shares.

We cannot credit that assertion. As we have seen, respondents' efforts during the period in question were directed at *avoiding* an investment in Big Horn.[8] However, even assuming they had wanted to make such an investment, why did they enter quotations in the sheets? They were well aware that this was the most difficult and expensive method of acquiring stock. They knew that the market was very thin and that the acquisition of even a smaller number of shares would drive up Big Horn's price. They were also well aware that there were easier and cheaper methods of obtaining a sizable position in Big Horn. As we have seen, Cole had often discussed with Collins the possibility of Big Horn's raising money through a private placement. There is nothing in the record to indicate that, in June and July of 1968, Big Horn would have been less than delighted to sell Collins all the stock he wanted at a reasonable price. Compliance with the Securities Act of 1933 would not have presented a serious problem since Big Horn already had an effective registration statement under that Act which could readily have been amended to include any stock sold to Collins.

Moreover, if respondents had really desired an investment in Big Horn, they could simply have waited a few weeks to see how many shares of warrant stock they could acquire. As noted above, the problem of the warrants' non-transferability was quickly resolved. But, of course, respondents weren't really interested in obtaining any warrant stock. As Hartley testified, Collins had arranged in advance to resell the 10,000 to 15,000 shares he thought registrant might be able to buy.

We are convinced that registrant did not enter quotations in the sheets for Big Horn in order to acquire a position. It did so for one purpose and one purpose only—to drive the price of the stock up to a level which would cause warrant holders to exercise or, to the extent that they did not and registrant exercised for them, to provide a basis for registrant's resales at a profit.

Respondents argue that in evaluating Collins' intent in entering the market, we must consider his sincere belief that Big Horn stock was worth more than $5 per share; that the market Douglass made in Big Horn was "bona fide"; that the record does not support any finding that Collins could expect finder's fees if the holding company became a reality; and that various elements found in other cases of manipulation were not present here.

Even if we accept for present purposes Collins' statement that he believed Big Horn stock was underpriced, this is no defense to a charge of manipulation. If, as we have concluded, Collins intended to, and did, artificially increase the price of the stock in order to induce warrant holders to buy, this is a manipulation and Collins' opinion as to the intrinsic value of the stock is irrelevant. Similarly, the allegedly

[7] We note that the hearing officer concluded that "the evidence does not prove that [Kornelsen] knew that manipulation of the market was taking place."

[8] Respondents point to the fact that, on August 23, 1968, at a time when the inter-dealer trading market for Big Horn had become very active and competitive, registrant put 10,000 shares of Big Horn stock into its investment account. Whatever the reasons for registrant's action at that time, we do not think it casts light on or provides an explanation for respondents' actions during the relevant period.

© 1975, Commerce Clearing House, Inc.

bona fide character of the market made by Douglass is no defense under the peculiar circumstances of this case. The pattern of trading by Douglass was such that it could be regarded as consistent with a legitimate effort on his part to acquire a position in the stock without unnecessarily raising its price. This is understandable since Douglass seems to have interpreted the instructions he received in that way. It does not appear that Douglass was aware of Collins' ulterior motives. But, obviously, manipulative trading tactics were not necessary to accomplish Collins' purpose. The market for Big Horn stock was very inactive and there does not appear to have been any significant floating supply of stock for sale, so that increasing bids by Douglass did not attract much stock. Under these circumstances, registrant could raise the quoted prices without aggressive buying and, as previously noted, the higher prices were then used to promote exercise of the warrants.

As for respondents' expectations of finder's fees, in addition to the previously mentioned Kornelsen letter, Irvine testified that, in February 1968, he pointed out to Collins that the planned holding company would be mutually advantageous in view of Collins' knowledge of other companies that could be placed in the holding company. And the record contains evidence that, after the holding company was established, registrant was slated to get the "standard" fee for one of its "finds"—5% of the first million dollars of purchase price, 4% of the second million, and so forth. Unfortunately for respondents, the particular deal fell through.

The fact that certain elements present in other cases of manipulation may not be present here is of no significance. As one court has said:

> "[Section 10(b) and Rule 10b-5] are not intended as a specification of particular acts or practices that constitute 'manipulative or deceptive devices or contrivances,' but are instead designed to encompass the infinite variety of devices that are alien to the 'climate of fair dealing' . . . that Congress sought to create and maintain."[9]

Finally, respondents calim that the administrative law judge overlooked the "overwhelming direct evidence of innocence in the record," pointing to the denials of Collins and others that there was any manipulation or plan to manipulate Big Horn stock. But, "since it is impossible to probe into the depths of a man's mind," a finding of manipulative purpose, absent an admission, must be based on inferences drawn from the evidence.[10] In this case, we find those inferences compelling.

Bids and Purchases During Distribution

Rule 10b-6 provides, in pertinent part, that it is a manipulative or deceptive device for a broker-dealer which is participating in a particular distribution of securities to bid for or purchase such securities until it has completed its participation in the distribution.

There can be little question that registrant participated in the distribution of Big Horn warrant shares. And, while participating in that distribution, it placed bids for Big Horn in the sheets and purchased Big Horn stock that was not a part of the offering for its own account. We find that registrant, willfully aided and abetted by Collins, willfully violated Section 10(b) of the Exchange Act and Rule 10b-6 thereunder.

Kornelsen played no part in registrant's market making or trading in Big Horn. He denies that he knew registrant was entering bids in the sheets and making market purchases at the time it was participating in the distribution of Big Horn warrant stock. On the basis of the record before us, we are unable to reach a contrary conclusion. Accordingly, we make no findings of violation against Kornelsen.

Registrant and Collins argue that there was no "distribution" within the meaning of Rule 10b-6. They point to the test we laid down for making that determination in the *Bruns, Nordeman* case— the magnitude of the offering and the selling efforts and selling methods utilized.[11] Respondents also contend that registrant was not an underwriter as defined in the rule.[12]

[9] *Herpich v. Wallace*, 430 F. 2d 792, 802 (C. A. 5, 1970).

[10] See *The Federal Corporation*, 22 S. E. C. 227, 230 (1947); *Halsey, Stuart & Co., Inc.*, 30 S. E. C. 106, 112 (1949).

[11] *Bruns, Nordeman & Company*, 40 S. E. C. 652, 660 (1961).

[12] Rule 10b-6(c)(1) defines underwriter as "a person who has agreed with the issuer or other person on whose behalf a distribution is to be made (A) to purchase securities for distribution or (B) to distribute securities for or on behalf of such issuer or other person or (C) to manage or supervise a distribution of securities for or on behalf of such issuer or other person."

Under our holding in *Jaffee & Co.*,[13] the *Bruns Nordeman* standard would be inapplicable here since an offering registered under the Securities Act would necessarily be a distribution within the meaning of Rule 10b-6. But we have reconsidered the proposition that registration of an offering *per se* makes Rule 10b-6 applicable. Instead we have concluded, as did Commissioner Smith dissenting in part in the *Jaffee* case, that this proposition does not comport with the intended coverage of the rule. As Commissioner Smith pointed out, the term distribution is not defined either in the Securities Act of 1933 or in the Securities Exchange Act of 1934 and its meaning and applicability to particular persons in each context should be derived from the differing purposes for which it is used.

The purpose of the Securities Act is to provide adequate disclosure about an issuer through the registration process in situations where registration is necessary and practicable. The Securities Act contemplates that registration will be required, absent some special exemption, when securities are publicly offered by or on behalf of an issuer or are purchased from an issuer for public resale, and the term "distribution" as used in the Act has been interpreted to accomplish that purpose. Thus, as Commissioner Smith pointed out, if an individual acquires 200 shares of an actively traded stock from the issuer and promptly sells them on an exchange, it is clear that registration would be required.

Rule 10b-6, on the other hand, is designed to prevent manipulation in the markets. To that end, it precludes a person from buying stock in the market when he is at the same time participating in an offering of securities which is of such a nature as to give rise to a temptation on the part of that person to purchase for manipulative purposes. The term distribution in Rule 10b-6 should therefore be interpreted to identify situations where that temptation may be present. Our opinion in *Bruns, Nordeman* attempted to define distribution so as to identify such circumstances.

If the term distribution in Rule 10b-6 were to be equated with the concept of public offering or distribution in the Securities Act, this would not only extend the restrictions of Rule 10b-6 beyond their intended purpose but could result in unnecessary disruption of the trading markets, particularly where an exchange specialist or other market maker acquires registered stock in the performance of his normal functions. It would obviously make no sense to conclude that a specialist, who happens to acquire some registered stock in the course of his normal activities, has to get out of the market until after he has disposed of that stock. No one has ever thought that such a result was required, even though specialists might well purchase registered stock being sold under a so-called "shelf registration."

We accordingly decline to hold that any offering of securities pursuant to a registration statement automatically constitutes a distribution within the meaning of Rule 10b-6, and the *Jaffee* decision, insofar as it is to the contrary, is overruled.[14]

This does not mean that a requirement that an offering be registered is irrelevant for purposes of determining the applicability of Rule 10b-6. Rule 10b-6 undoubtedly applies to most registered offerings. Indeed, that rule, and its companions, Rule 10b-7 and Rule 10b-8, were framed in contemplation of such offerings, although Rule 10b-6, of course, may apply to a distribution which is, for some reason, exempt from registration under the Securities Act. The present case is an example of a registered offering to which Rule 10b-6 does apply. As pointed out above, registrant acquired 75,694 shares of Big Horn stock, issued pursuant to the warrants, and proceeded to distribute 73,460 of those shares at a price of 5⅛, or approximately $360,000, between July 22 and July 25. Considering the activity, or rather lack of it, in the trading market for Big Horn, and the fact that the offering amounted to more than 30% of the outstanding stock, the sales effort was of such magnitude that there was unquestionably a distribution for purposes of Rule

[13] 44 S. E. C. 285, 288 (1970).

[14] We do not regard the decision of the United States Court of Appeals for the Second Circuit in *Jaffee & Co. v. S. E. C.*, 446 F. 2d 386 (1971), affirming in part and reversing in part our decision in *Jaffee & Co.*, as in any way inconsistent with the conclusion we now reach. The court in that case did not consider the question of whether the fact of registration in and of itself resulted in a distribution for purposes of 10b-6; rather, it found that Mr. Jaffee, as the largest participant in a substantial offering, amounting to 28% of the outstanding stock of the issuer, was subject to Rule 10b-6, and devoted much of its opinion to considering and rejecting Jaffee's contention that various exemptions from Rule 10b-6 were available to him.

© 1975, Commerce Clearing House, Inc.

10b-6. Registrant appears to have been an underwriter and certainly was, at least, a participant in that distribution.

Regulation T

The hearing officer found that, in twenty instances during the period April 1967 to September 1968, registrant violated Regulation T by failing to cancel promptly or otherwise liquidate transactions of customers who failed to pay for the securities they purchased within the required times —7 business days in ten transactions governed by Section 4(c)(2) of the regulation, and 35 calendar days in ten transactions to which Section 4(c)(5), covering arrangements for payment against delivery ("C.O.D. accounts"), was applicable. Collins was held responsible for these violations.

Respondents do not deny that the violations occurred. But they point to their small number and argue that Collins, as the chief executive officer of a large broker-dealer firm, could not be expected to follow up every trade to assure that timely payment was made or the trade cancelled.[15]

Initially, we note that the violations found were the result of, at most, a 10% check of registrant's accounts. But whatever the number of violations, the president of a broker-dealer firm has the responsibility for compliance with all applicable requirements.[16] And he retains that responsibility unless and until he reasonably delegates a particular function to another person in the firm, and neither knows nor has reason to know that the person in question is not properly performing his duties.[17]

Here, there was no such reasonable delegation. Prior to the end of 1967, registrant's cashier, Mrs. K., was responsible for compliance with Regulation T. She had been hired as a receptionist-secretary in January 1965 and had no prior cashiering experience. Yet, after only a few months of "on-the-job training," she became cashier in July 1965. In May 1966, replying to a letter from our staff pointing out some apparent violations of Regulation T, Collins blamed several of the infractions on Mrs. K's incompetence. Mrs. K. admittedly did not understand C.O.D. accounts or the 35-day rule. She testified, however, that she learned a lot from her mistakes.

In late 1967, Mr. S., a certified public accountant, was put in charge of all of registrant's back office functions including cashiering.[18] Mr. S. had never previously done any accounting work in securities, and never received any formal or informal training at registrant with respect to Regulation T. Like Mrs. K., he did not understand the 35-day rule until it was explained to him by Midwest Stock Exchange inspectors. He admitted that registrant's Regulation T procedures were inadequate, but that in any event the prevalent thinking in the back office was that it was better to attempt to collect money due than cancel a transaction. He himself never cancelled a transaction until late in 1968. According to Mr. S., he became more competent in the Regulation T area as the year 1968 went on.

Under the circumstances, we think Collins was clearly responsible for the violations that occurred. We conclude that registrant, willfully aided and abetted by Collins, willfully violated Section 7(c) of the Exchange Act and Regulation T promulgated thereunder by the Board of Governors of the Federal Reserve System.

Recordkeeping Violations

The hearing officer found that, in recording registrant's purchases of warrant stock and in certain other respects, registrant and Collins failed to comply with recordkeeping requirements.

(a) The warrant transactions presented a peculiar problem in recordkeeping. The warrants on their face were non-assignable. This restriction, however, became unnecessary as a result of the 1967 registration of the underlying stock. It would probably have been closer to reality to view the restriction as inoperative and, therefore, to have recorded the transactions as purchases by registrant, as assignee of the warrants, from Big Horn. On the other hand, in light of the restriction, registrant recorded the transactions as purchases of stock from the warrant holders. This manner of treating this unusual situation would not appear to make any difference to anyone. Conse-

[15] Respondents also address arguments to the provisions of Section 15(b)(5)(E) of the Exchange Act which deals with inadequate supervision. These are wholly inapposite. The administrative law-judge held Collins *substantively* responsible for registrant's violations of Regulation T, as well as its recordkeeping and reporting infractions which are discussed below.

[16] *Alfred Miller*, 43 S. E. C. 233, 239-40 (1966).

[17] See Barraco and Company, 44 S. E. C. 539, 541 (1971).

[18] Prior to that time, registrant's books and records were maintained by a bookkeeper.

quently, we do not believe that this procedure should be found to be a violation of recordkeeping requirements.

(b) Respondents do not contest the hearing officer's finding that, prior to August 1968, registrant's position record did not comply in several respects with the requirements of our Rule 17a-3(a)(5) under the Exchange Act. They argue, however, that as long as the requisite information was contained elsewhere in registrant's records, the rule was satisfied. They also point to the fact that the record they maintained was part of a bookkeeping system designed specifically for broker-dealers by the National Cash Register Company.

The fact that the data required in the position record might have been derived from other records maintained by registrant did not satisfy the requirements of our rule.[19] As the hearing officer stated:

> "That the information . . . was available to an investigator who, with effort and perhaps some measure of luck, might search and make comparisons is not an answer to the charge."

Collins' reliance on the National Cash Register bookkeeping system which he installed at registrant, while possibly a mitigative factor, obviously cannot relieve him of responsibility for his firm's deficient position record.

(c) Certain of registrant's order memoranda did not reflect the time of entry and the time of execution or cancellation of the order as required by our Rule 17a-3(a)(6) under the Exchange Act. Respondents point to Douglass' testimony that registrant's branch offices, where the transactions in question originated, normally time-stamped copies of all order tickets. Testimony as to a general practice, however, cannot be accepted as evidence of what was actually done in the eight instances where we find violations. Responsibility for proper recordkeeping in this area was properly delegated to Douglass, and we do not find Collins responsible for these violations.

We conclude that, in the indicated respects, registrant, willfully aided and abetted by Collins with respect to the firm's position record, willfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.

Reporting violations

Respondents admit, and we find, that registrant willfully violated Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder and Section 203(c) of the Investment Advisers Act and Rule 204-1 thereunder in that it failed to file promptly required amendments to its applications for broker-dealer and investment adviser registration. Registrant did not promptly report a 1970 change of address in its principal office from Denver to New York City, and the promotions of Smith and Mr. S. to vice-president in the latter part of 1968. In addition, after Douglass' promotion to vice-president in 1966, registrant did not promptly supply required information with respect to his prior connections with other broker-dealers.

Collins was admittedly responsible for filing such amendments prior to the time Mr. S. assumed that responsibility in mid-1968. We accordingly find that Collins willfully aided and abetted registrant's violations resulting from its failure promptly to furnish required information concerning Douglass.

Alleged Violations of Section 5(b)(1) of the Securities Act

The hearing officer found that the "pink sheets" which carried registrant's offers to buy Big Horn stock were prospectuses, as defined in Section 2(10) of the Securities Act, and that, since they obviously did not contain all of the information required in a statutory prospectus, registrant and Collins violated Section 5(b)(1) of that Act.

This novel, and on its face startling proposition, finds some verbal support in the Broad language of 2(10) which refers to any ". . . communication, written or by radio or television, which offers any security for sale. . . ." However, it ignores some 40 years of history, goes beyond the statutory purpose, does nothing to serve that purpose, and would create unnecessary complications in the trading markets. Section 5(b) of the Act has two principal purposes: first, to insure that buyers of registered securities get the statutory prospectus and, secondly, to make sure that selling literature and other offering material is used only when it has been preceded by a statutory prospectus so that people will not be influenced by such solicitation to

[19] *Associated Securities Corporation*, 40 S.E.C. 10, 18 (1960), *aff'd* 293 F. 2d 738 (C. A. 10, 1961); *Whitney & Company*, 41 S. E. C. 699, 703 (1963); *Eugene N. Owens*, 42 S. E. C. 149, 151 (1964).

© 1975, Commerce Clearing House, Inc.

buy before they see the prospectus. The proposition with respect to the pink sheets, which would extend to NASDAQ or any other quotation system, would not further the first purpose and is only marginally applicable to the second. On the other hand, acceptance of that proposition would mean, for example, that where, as is very commonly the case, a market maker inserts quotations for a new issue in a quotation medium shortly after the offering has been completed, he would not only have to provide a prospectus to everybody who buys from him, as required by Section 5(b), but would also have first to send a prospectus to each of the thousands of subscribers to the quotation service even though most of them would have no interest in the issue in question, having subscribed by reason of an interest in some of the hundreds, or thousands, of other issues quoted in such medium. This, as a practical matter, would make market making impossible until after the 40-day prospectus-delivery period specified in Section 4(3)(B) of the Act had expired. This wholly unreasonable result surely was not intended by the Congress, which was aware that quotation media existed.[20]

Standard of Proof

Registrant and Collins argue that the administrative law judge erred in basing his decision on the preponderance of the evidence and that the standard he should have applied was "clear, unequivocal and convincing" proof.

As respondents point out, the Supreme Court has held the stricter standard applicable to denaturalization and deportation cases because of the "drastic depreviations" which those sanctions entail.[21] But that standard has never been held applicable to broker-dealer proceedings under the Exchange Act. Such proceedings are remedial.[22] This means that a preponderance of the evidence is sufficient to establish the truth of an allegation.[23] That standard satisfies the Administrative Procedure Act's requirement of "reliable, probative and substantive evidence."[24]

Public Interest

As noted above, the hearing officer concluded that registrant's broker-dealer and investment adviser registrations should be revoked, that registrant should be expelled from NASD membership and that Collins should be barred from association with any broker or dealer. Respondents argue that the public interest does not require such severe sanctions. They assert, among other things, that the Big Horn transactions were a very minor percentage of registrant's activities and involved a security "underpriced in the marketplace," that unrebutted character testimony evidenced the fine reputation of registrant as well as Collins' "fifteen exemplary years" in the securities business, and that the back office violations were inadvertent and unintentional and occurred at a time of unprecedented volume in the industry.

Manipulation strikes at the integrity of the pricing process on which all investors rely. Hence it runs counter to the basic objectives of the securities laws. As the Senate Committee stated in its report on the Exchange Act:

> "The purpose of the act is . . . to purge the securities exchanges of those practices which have prevented them from fulfilling their primary function of furnishing open markets for securities where supply and demand may freely meet at prices uninfluenced by manipulation or control."[25]

That is why we find ourselves wholly unable to view respondents' derelications as trivial peccadilloes. The Big Horn transactions may have been only "a small percentage" of registrant's business. But the record shows that they were very important to respondents' future plans. To realize

[20] Since we have found that registrant and Collins were substantively responsible for the antifraud violations set forth above, we consider it unnecessary to consider the further issue raised herein of whether they failed to exercise proper supervision with a view to preventing these violations. *Cf. Fox Securities Company, Inc.*, Securities Exchange Act Release No. 10475 (November 1, 1973), 2 SEC Docket 667, 669 and cases there cited.

[21] *Schneiderman v. United States*, 320 U. S. 118, 125 (1943); *Woodby v. I. N. S.*, 385 U. S. 276, 285-6 (1966). *Cf. Sumner B. Cotzin*, Securities Exchange Act Release No. 10850 (June 12, 1974), 4 SEC Docket 420, 422 and 424 n. 14.

[22] See, e.g., *Blaise D'Antoni & Associates, Inc. v. S. E. C.*, 289 F. 2d 276, 277 (C. A. 5, 1961); *Pierce v. S. E. C.*, 239 F. 2d 160, 163 (C. A. 9, 1956).

[23] *Norman Pollisky*, 43 S. E. C. 458, 459-60 (1967); *James De Mammos*, 43 S. E. C. 333, 337 (1967), *aff'd without opinion* (C. A. 2, October 13, 1967).

[24] *Norman Pollisky, supra.*

[25] S. Rep. No. 1455, 73d Cong., 2d Sess., p. 81 (1934). See also the preambles to the Exchange and Securities Acts and Section 2 of the Exchange Act.

those plans they resorted to manipulation and fraud. That demonstrates their unfitness to be in the securities industry. Respondents' claim that investor losses from Big Horn were "minimal or nonexistent" ignores the fact that all of registrant's customers sustained losses to the extent of the overpayments caused by respondents' manipulation of the Big Horn market.[26]

While the business community may have a good opinion of respondents, that opinion can hardly be shared by regulatory authorities. The record shows that respondents have been sanctioned in five other disciplinary proceedings. In 1966, the NASD found that registrant[27] charged customer unfair prices and sent them investment company sales literature which did not conform to our Statement of Policy. Collins was held responsible for inadequate supervision both in connection with those violations and with respect to the embezzlement of funds by the firm's cashier.[28] In 1970, the NASD found that registrant maintained a discretionary account for a customer without prior written authorization and effected transactions in the account without her knowledge or consent.[29] The Division of Securities of the State of Colorado additionally found, with respect to the same account, that registrant purchased speculative securities that were not suitable for the customer's financial condition, and sold the account securities that were not registered in Colorado as required. In May 1973, the NASD sanctioned registrant and Collins on the basis of Collin's admission and acknowledgment of responsibility for (a) a failure to time-stamp order tickets, (b) a deficient customer ledger, (c) a failure to keep the firm's position record current and (d) a failure to conduct required quarterly "box counts."[30] And action was taken by the NASD against respondents on a similar basis in August 1973 with respect to an admitted net capital violation for the period February 1972 to March 1973.[31]

Similarly, respondents' argument that their back office violations were merely part of the general "paperwork logjam" in 1968 will not withstand scrutiny. In fact, those violations were part of a continuing pattern of infractions demonstrating respondents' inability or unwillingness to comply with applicable requirements. We have already noted the back office violations found by the NASD in 1973. In 1965, our staff wrote registrant to call attention to an apparent net capital violation, "a seriously large number" of Regulation T violations, a failure to maintain required employee questionnaires, and a failure to send customers statements reflecting free credit balances in their accounts. Collins replied that procedures had been adopted which he felt would "prevent recurrences of the practices described in your letter." In 1966, our staff complained of additional violations of Regulation T and a failure to time-stamp order tickets. In reply, Collins stated that adjustments had been completed and "present controls [were] completely satisfactory."

Respondents additionally argue that the "alleged" violations happened a long time ago, that we have imposed lesser sanctions in more serious cases, that they have already suffered severely from the expense and burden of defending against the charges herein, and that the firm now conducts primarily an institutional business, having no discretionary accounts and only a handful of retail accounts.

A lapse of time following the misconduct at issue is necessarily involved in all broker-dealer proceedings that come before us.[32] Here, as in every such case, an investigation had to be made before charges could be brought. And in this proceeding the many issues raised were litigated vigorously both before the hearing officer and before us.[33] Moreover, as noted above, respond-

[26] See *Atlantic Equities Company*, 43 S. E. C. 354, 368 (1967), and cases there cited.
[27] Registrant was then known as Collins, Eatherton & Associates, Inc.
[28] NASD District No. 3, Complaint No. 228.
[29] NASD District No. 3, Complaint No. 226.
[30] NASD District No. 12, Admission, Waiver and Consent No. 6.
[31] NASD District No. 12, Admission, Waiver and Consent No. 32.
[32] See *Haight & Company*, 44 S. E. C. 451, 513 1971), *aff'd without opinion* (C. A. D. C. June 30, 1971).
[33] Of course, respondents had every right to defend themselves with zeal and persistence. But having exercised that right, they cannot then ask us to forget the whole thing or at any rate view it indulgently because the case has dragged on for such a long, long time. Were administrative litigation a game, we might perhaps deem ourselves free to award bonus points based on counsel's ingenuity and persistence. But it is not a game. It is a very serious business that requires that cases be decided on the basis of the records made in them and that those records be read in light of the objectives that Congress sought to promote when it passed the statutes we administer.

© 1975, Commerce Clearing House, Inc.

ents engaged in misconduct subsequent to the period at issue here.

As for the sanctions imposed in other cases, the remedial action which is appropriate in the public interest depends on the facts and circumstances of each particular case and cannot be precisely determined by comparison with that taken in other proceedings.[34] Here we have found serious and extensive violations coupled with a record of persistent noncompliance with the requirements of the securities acts.

Respondents normally spend time and money to defend themselves. So these respondents' decision to do so is of minimal mitigative weight. As for the claimed change in the nature of registrant's business, the misconduct we have found includes the defrauding of institutional clients which, according to respondents, form the bulk of their present clientele.

Nevertheless, we think it unnecessary to bar Collins forever from all segments of the securities industry. Consequently, we shall impose a bar but provide that, after two years, Collins may apply for leave to return to the securities business. In view of what happened in the instant case, however, any such return may not be in any position directly or indirectly connected with the making of markets in securities. We affirm the sanctions imposed by the administrative law judge on Collins Securities Corporation.

Having found no violations by Kornelsen, we dismiss as to him.

An appropriate order will issue.

By the Commission (Chairman GARRETT and Commissioners LOOMIS, EVANS, and SOMMER); Commissioner POLLACK not participating.

[¶ 80,328] Arranging for Credit by a Broker or Dealer.

Board of Governors of the Federal Reserve System. November 13, 1975. Release in full text.

Regulation T—Brokers and Dealers—"Arranging" of Credit—Private Placement.—The proposed amendment to Section 220.7(a) as revised, is hereby adopted. This is intended to relax the present rule that generally prohibits a broker or dealer from arranging credit unless it is the kind of credit a broker or dealer can extend. The types of private placements this amendment envisions are (1) those privately placed securities which are debt securities, the proceeds of which are used to purchase stock which is not publicly held, and (2) those privately placed securities which are investment contracts with built-in instalment or other credit features.

See ¶ 22,231, "Exchange Act—Margin; Borrowing Restrictions" division, Volume 2.

On June 2, 1975, the Board of Governors published for comment in the Federal Register (40 F. R. 23768) a proposed amendment to section 220.7(a) of Regulation T which would relax the present rule that generally prohibits a broker or dealer from arranging credit unless it is the kind of credit a broker or dealer can extend.

The comments received were all favorable although many suggested enlarging the scope of the amendment. Some commentators suggested that the amendment be expanded to permit the arranging for credit extended in connection with securities sold pursuant to the "intra-State" exemption from registration contained in section 3(a)(11) of the Securities Act of 1933 (15 U. S. C. 77c(a)(11)). Such an expansion, however, would provide no relief for any person who acts as both a broker and a dealer in the distribution of a security because of the prohibitions of section 11(d) of the Securities Exchange Act of 1934 (15 U. S. C. 78k(d)) and would otherwise appear to offer minimal benefit to brokers or dealers. Other suggested areas of expansion do not appear to the Board to be appropriate at this time.

Several commentators suggested changes in the language to ensure that the status of the security at the time credit for its purchase is arranged should be controlling [illegible] historical or prospective

[34] See *Butz v. Glover Livestock Commission Co.*, 411 U. S. 182, 187 (1973); *Hiller v. S. E. C.*, 429 F. 2d 856, 858-9 (C. A. 2, 1970).

ADDENDUM B

High and Low Bids and Spread: June 1 to June 25, 1971

Date	High Bid	Low Bid	Spread
6/1	$13	$13	--
6/2	13-1/2	13-1/4	1/4
6/3	13-5/8	13-1/2	1/8
6/4	13-5/8	13-1/2	1/8
6/7	13-5/8	13-1/4	3/8
6/8	14-1/4	12-3/4	1-1/2
6/9	13-3/4	12-1/2	1-1/4
6/10	13	12-7/8	1/8
6/11	12-7/8	12-3/4	1/8
6/14	12-1/2	12-3/8	1/8
6/15	12-3/4	11-5/8	1-1/8
6/16	12	11	1
6/17	12-1/4	11	1-1/4
6/18	12-3/4	12-1/8	5/8
6/21	12-7/8	12-3/4	1/8
6/22	12-7/8	10-1/4	2-5/8
6/23	10-3/4	9-1/4	1-1/2
6/24	10-5/8	9-3/8	1-1/4
6/25	10-1/2	10-3/8	1/8

ADDENDUM C

Actual Re-Sales against Pink Sheet Quotes

(1971) Date	Resale Price	Sales for Byrnes	Sales for Santangelo	Pink Sheet High Bid	Pink Sheet Low Bid
8/9	$9		700	$9	$8-3/4
8/10	9	2,800	300	9	8-3/4
	9-1/8	200			
8/11	9	2,700		9	8-3/4
	9-1/8	300			
	9-1/4	2,000			
8/12	9-3/8	500		9-3/8	8-7/8
	9-1/2	1,500			
8/17	9-1/2	200		9-3/8	9-1/4
	9-5/8		1,000		
8/20	9-1/4	1,550		9-1/4	9-1/8
	9-3/8	1,000			
8/24	9-1/2		100	9-3/8	8-7/8
8/25	9		2,400	9-3/8	8-7/8
	9-1/4		3,400		
	9-3/8		200		
9/2	8-1/4	2,000		8-5/8	8-1/8
9/7	7-1/2	250		8	7-7/8
	7-5/8	1,500			
9/8	7-3/8	1,000		7-5/8	7-1/2
9/13	8		2,000	7-3/4	7-1/2
	8-1/2		1,300		
	9		1,500		
	9-1/4		500		
	9-3/8		1,700		
9/14	9	1,250	1,600	9-3/8	8-1/4
9/15	9-1/8	1,000	1,000	8-7/8	8-7/8
	9-1/4		1,300		
9/16	9-3/8	1,000	1,000	9-3/8	9
9/17	9	800		9-3/8	9-1/4
	9-1/8	450			
9/28	9		2,000	8-1/2	8
Total (Faulkner)		22,000	22,000		
9/17	9-1/8	750		9-3/8	9-1/4
9/28	9		100	8-1/2	8
9/29	9-1/4		300	9	8-3/4
	9-3/8		350		
Total (Singer)		750	750		

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss.:

SCOTT ALVINO, being duly sworn, deposes and says that deponent is not a party to the action, is over 18 years of age and resides at 5701 15 AVE BROOKLYN N.Y.

That on the 16 day of AUGUST, 1976, deponent personally served the within BRIEF OF THE PLAINTIFFS-APPELLANTS + COUNTERCLAIM DEFENDANTS-APPELLANTS upon the attorneys designated below who represent the indicated parties in this action and at the addresses below stated which are those that have been designated by said attorneys for that purpose.

By leaving 4 true copies of same with a duly authorized person at their designated office.

~~By depositing~~ _____ true copies of same ~~enclosed in a postpaid properly addressed wrapper,~~ in the post office or official depository ~~under the exclusive~~ care and custody of the United ~~States~~ post office department within the ~~State of New York~~.

Names af attorneys served, together with the names of the clients represented and the attorneys' designated addresses.

JACOBS PERSINGER + PARKER
ATTORNEYS FOR DEFENDANT-APPELLEE
AND COUNTERCLAIM PLAINTIFF-APPELLEE, APPELLANT
FAULKNER DAWKINS + SULLIVAN
70 PINE ST.
NEW YORK, N.Y.

Scott Alvino

Sworn to before me this
16 day of August, 1976

Michael DeSantis

MICHAEL DeSANTIS
Notary Public, State of New York
No. 03-0930908
Qualified in Bronx County
Commission Expires March 30, 1978

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss.:

STEVEN SHEA, being duly sworn, deposes and says that deponent is not a party to the action, is over 18 years of age and resides at 1221 EAST 54 ST BROOKLYN, N.Y.

That on the 16 day of AUGUST, 1976, deponent personally served the within BRIEF OF THE PLAINTIFFS-APPELLANTS & COUNTERCLAIM DEFENDANTS-APPELLANTS upon the attorneys designated below who represent the indicated parties in this action and at the addresses below stated which are those that have been designated by said attorneys for that purpose.

By leaving 2 true copies of same with a duly authorized person at their designated office.

~~By depositing _____ true copies of same enclosed in a postpaid properly addressed wrapper, in the post office or official depository under the exclusive care and custody of the United Stated post office department within the State of New York.~~

Names af attorneys served, together with the names of the clients represented and the attorneys' designated addresses.

HALL, DICKLER LAWLER KENT & HOWLEY
ATTORNEYS FOR COUNTERCLAIM-DEFENDANT-APPELLEE
TOBEY & KIRK
460 PARK AVE
NEW YORK, N.Y. 10022

Steven Shea

Sworn to before me this
16 day of August, 1976

Michael DeSantis

MICHAEL DeSANTIS
Notary Public, State of New York
No. 03-0030908
Qualified in Bronx County
Commission Expires March 30, 1978

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss.:

Murray H. Berman, being duly sworn, deposes and says that deponent is not a party to the action, is over 18 years of age and resides at 78 2nd Ave NY NY 10003.

That on the 16 day of AUGUST, 1976, deponent personally served the within BRIEF OF THE PLAINTIFFS-APPELLANTS + COUNTERCLAIM-DEFENDANTS-APPELLANTS upon the attorneys designated below who represent the indicated parties in this action and at the addresses below stated which are those that have been designated by said attorneys for that purpose.

By leaving 2 true copies of same with a duly authorized person at their designated office.

~~By depositing _____ true copies of same enclosed in a postpaid properly addressed wrapper, in the post office or official depository under the exclusive care and custody of the United Stated post office department within the State of New York.~~

Names af attorneys served, together with the names of the clients represented and the attorneys' designated addresses.

BORDEN + BALL
ATTORNEYS FOR DEFENDANT-APPELLEE
SINGER + MACKIE, INC.
201 EAST 50th ST.
NEW YORK, N.Y. 10022

Murray H Berman

Sworn to before me this
16th day of August, 1976

Michael DeSantis

MICHAEL DeSANTIS
Notary Public, State of New York
No. 03-0930908
Qualified in Bronx County
Commission Expires March 30, 1977

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss.:

ROBERT LA GRASA, being duly sworn, deposes and says that deponent is not a party to the action, is over 18 years of age and resides at 62-20 60th RD MASPETH, N.Y.

That on the 16 day of AUGUST, 1976, deponent personally served the within BRIEF OF THE PLAINTIFFS-APPELLANTS & COUNTERCLAIM. DEFENDANTS-APPELLANTS upon the attorneys designated below who represent the indicated parties in this action and at the addresses below stated which are those that have been designated by said attorneys for that purpose.

~~By leaving true copies of same with a duly authorized person at their designated office.~~

By depositing 2 true copies of same enclosed in a postpaid properly addressed wrapper, in the post office or official depository under the exclusive care and custody of the United Stated post office department within the State of New York.

Names af attorneys served, together with the names of the clients represented and the attorneys' designated addresses.

SECURITIES & EXCHANGE COMMISSION
AMICUS CURIAE
500 NORTH CAPITAL ST - N.W
WASHINGTON DC 20549
ATTN: LAWRENCE HORN

Robert La Grasa

Sworn to before me this
16 day of August, 1976

Michael DeSantis

MICHAEL DeSANTIS
Notary Public, State of New York
No. 03-0930908
Qualified in Bronx County
Commission Expires March 30, 1978

Counsel Press, 55 West 42nd Street, PE 6-8460
(5606B)